

360 Madison Avenue
New York, NY 10017-7111
Telephone 646.637.9200
Fax 646.637.9126
www.bondmarkets.com

1399 New York Avenue, NW
Washington, DC 20005-4711
Telephone 202.434.8400
Fax 202.434.8456

St. Michael's House
1 George Yard
London EC3V 9DH England
Telephone 44.20.77 43 93 00
Fax 44.20.77 43 93 01

November 16, 2005



Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File Number SR-NASD-2004-026
Proposed Amendment No. 4 Concerning NASD Rule 2320(a)
Governing "Best Execution"

Dear Mr. Katz:

The Bond Market Association ("Association")¹ appreciates the opportunity to comment on the Amendment No. 4 ("Amendment 4") to the above-referenced proposal (the "Proposal"), submitted by the National Association of Securities Dealers ("NASD") to amend NASD Rule 2320 (the "Rule"). For the reasons stated below, the Association respectfully reiterates the position stated in its previous comment letters concerning the Proposal, dated April 5, 2005 and September 7, 2005 (the "Prior Comment Letters"), that the Commission should **not approve** the Proposal unless the Commission clarifies how the Proposal applies to the bond market. For convenient reference, the Prior Comment Letters are attached hereto as Annex A and B, respectively.

Among other things, the Proposal would extend certain due diligence obligations not just to an NASD member firm's own customers, but also to orders of the customers of another broker-dealer. The Association appreciates, and concurs with, the NASD's clarification in Amendment 4 that an NASD member firm's obligation of best execution "does not apply when another broker-dealer is simply executing a customer order against the member's quote" and that "the duty to provide best execution to customer orders arises only when an order is routed from the broker-dealer to the member for the purposes of order handling and execution." However, the Association respectfully submits that Amendment 4 does not properly or constructively address the other concerns expressed in the Prior Comment Letters. Specifically, the NASD's Proposal, as amended through Amendment 4, fails to provide guidance to the bond markets regarding two vital questions: (1) when do the best execution obligations specified in the Rule apply to

¹ The Association represents securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally. The Association's member firms collectively represent in excess of 95% of the initial distribution and secondary market trading of municipal bonds, corporate bonds, mortgage and other asset-backed securities and other fixed income securities. More information about the Association is available on its website www.bondmarkets.com.

transactions in the bond market, and (2) where the obligations specified in the Rule do apply, how should bond market participants discharge those obligations given the nature of the bond market?

Regarding the uncertain application of the Rule to the bond market, the Association notes that Amendment 4 supports the premise (with which the Association concurs) that best execution is strictly an agency concept by clarifying that best execution is not applicable when an NASD member receives a customer order through another broker-dealer for execution against the member's stated quote. However, in the Association's view, best execution obligations should *never* apply when a dealer is merely executing against a stated quotation and has not been entrusted with an order to handle as agent, irrespective of whether the order is presented by another broker-dealer or by the customer himself.² Amendment 4 is deficient insofar as it fails to state affirmatively this fundamental point. Similarly, in the context of the bond market, where the vast preponderance of trading takes place on a dealer/principal basis, neither the existing Rule nor Amendment 4 indicates when a broker-dealer will be regarded as holding or handling an "order" as agent in a manner that gives rise to best execution duties. In addition, bond market participants are perplexed regarding how, if at all, best execution obligations apply to the situation where a customer asks an NASD member firm to act as the customer's agent in purchasing for the customer's account bonds having specified characteristics (such as maturity, call features, credit rating and yield), but where the customer is indifferent to, or is not specific regarding, the particulars of the issuer or the specific series of bond and leaves up to the member firm's discretion the choice of which bonds meeting the specified criteria to purchase. The Rule is cast in terms of a Member's obligations in seeking out the best market for particular instruments that the Member is purchasing or selling for the client. The application of the Rule is unclear where the customer is not seeking to purchase a *specific* security.

Assuming it is possible to identify those situations in which best execution duties attach, the Rule, both as it exists and as it is proposed to be amended, is also deficient in explaining how the "due diligence" standards set forth in Rule 2320(a) should be applied to various transactions in the bond market. As an example, there is nothing in the Rule or the proposed amendments that affords *constructive* guidance regarding what constitutes a "market" for purposes of the due diligence factors specified in the Rule,³ which markets should be consulted, or how many? Likewise, the manner in which the "accessibility" factor is to be considered remains extremely murky, and the degree (if any) to which the

² Although this result is *implied* by Paragraph (f) of Rule 2320.

³ For example, can a single dealer be a "market" for this purpose? If so, are all dealers "markets"?

availability and quality of information available through the TRACE system should or may be considered is not addressed.⁴

For the aforementioned reasons, the Association again respectfully submits that the NASD has not adequately responded to the Association's comments, and that Amendment 4 is therefore defective based upon the requirements of Form 19b-4.⁵ More fundamentally, the Association believes that the Proposal, at least insofar as it relates to the bond market, fails to meet the requirements of Section 15A(b) of the Act, which establishes the standards for the rules of a national securities association. The Association reiterates that it would appreciate the opportunity to engage in further dialogue with the SEC and the NASD regarding both the Proposal, as a whole, and Amendment 4, and would welcome the chance to assist in the development of workable rules to govern best execution in the bond markets.

If you have any questions concerning these comments, or would like to discuss any of our comments further, please do not hesitate to contact me at 646-637-9220.

Sincerely,

/s/ Michele C. David

Michele C. David,
Vice President and
Assistant General Counsel

⁴ In the view of the Association, the crumb of interpretive guidance contained in Amendment 3 regarding both the term "market" and the "accessibility" factor are so vague as to leave compliance with the Rule in the context of the bond market a matter of guesswork.

⁵ Exchange Act Form 19b-4 provides that: "If written comments were received (whether or not comments were solicited) from members of or participants in the self-regulatory organization or others, [the applicant must] summarize the substance of all such comments received and respond in detail to any significant issues that those comments raised about the proposed rule change." The Association does not believe that the NASD has met this standard in Amendment 4.

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. Nazereth, Commissioner
Giovanni P. Prezioso, General Counsel
Robert L.D. Colby, Deputy Director, Division of Market Regulation
Chester S. Spatt, Chief Economist, Office of Economic Analysis
Katherine A. England, Assistant Director, Division of Market Regulation
Joseph Morra, Division of Market Regulation
Timothy Welsh, Division of Market Regulation

NASD Regulation, Inc.

Robert R. Glauber, Chairman and Chief Executive Officer, NASD
Mary L. Schapiro, Vice Chairman, NASD and President, Regulatory
Policy and Oversight
Marc Menchel, General Counsel, Regulatory Policy and Oversight
Douglas Shulman, President, Markets, Services, and Information, NASD
Stephen I. Luparello, Executive Vice President, Market Regulation and US.
Exchange Solutions
Malcolm Northam, Director of Fixed Income Securities Examinations and Staff
Liaison to the NASD Fixed Income Committee

NASD Fixed Income Committee

Joseph A. Sullivan, Chairman

NASD Corporate Debt Market Panel

John J. Brennan, Chairman

The Bond Market Association

Corporate Credit Markets Division Executive Committee
Corporate Credit Markets Division Legal Advisory Committee