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THE BOND MARKET ASSOCIATION

July 23, 2004

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: File No. SR-NASD-2004-094 Relating to Proposed Amendments to TRACE Rule 6250 and Related TRACE Rules to Disseminate Transaction Information on All TRACE-Eligible Securities and Facilitate Dissemination

The Bond Market Association ("Association")[1] is pleased to submit this comment letter to the Securities and Exchange Commission ("SEC" or "Commission") in connection with the proposal (the "Proposal" or "Amendment") by the National Association of Securities Dealers, Inc. ("NASD") to amend Rule 6210 to modify the defined terms "Investment Grade" and "Non-Investment Grade" and to add a new defined term "Split-Rated", to amend rule 6250 to expand dissemination to include all TRACE-eligible securities and to delete provisions regarding market aggregate and last sale data and the treatment of certain transaction reports, and to amend Rule 6260 to adjust the notification provisions to require information needed to implement various dissemination schedules, and to make certain minor, technical changes.[2]

I. Introduction

The Association applauds the NASD's continuing efforts to create a workable and sound rule governing the reporting and dissemination of secondary market trade information for corporate bonds, and commends the NASD's long-term goal of increased transparency for investors and other market participants under an expanded TRACE dissemination scheme. The Association is committed to making the bond markets more transparent, particularly for the retail investor, and as part of this commitment disseminates TRACE corporate bond price information free of charge on its investor education website, www.investinginbonds.com.

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[1] The Association represents firms and banks that underwrite, distribute and trade in fixed income securities, both domestically and internationally. More information about the Association is available on its website at www.bondmarkets.com. This comment letter was prepared in consultation with various committees of the Association's Corporate Credit Markets Division.

[2] See Exch. Act Rel. No. 49,920 (June 25, 2004); 69 Fed. Reg. 40,429 (July 2, 2004) ("Proposing Release").

The Association, through the five members it nominates to the NASD's Bond Transaction Reporting Committee ("BTRC"), has been an active participant in the process of advising the NASD on the implementation and expansion of TRACE and the development of the current Proposal to expand dissemination. While we appreciate the opportunity to participate in the formulation of the Proposal, and recognize the NASD's efforts to include the perspectives and concerns of the broker-dealer community in its deliberations on this subject, our membership continues to have serious concerns about potential harm to liquidity resulting from rapid dissemination of transaction data on lower rated, less frequently traded issues. While the Proposal does afford some protection for large trades in these issues, we believe the delayed dissemination it proposes does not go far enough to protect liquidity. We urge the NASD to carefully monitor and measure the effects of increased dissemination for these issues, and to seek on an expedited basis any appropriate adjustments to the proposed dissemination scheme should harm to liquidity be shown to result. Additionally, we urge the NASD to make consolidated trade data publicly available to all market participants following the implementation of the Proposal, to allow the industry an opportunity to evaluate and assess any impact on liquidity.

II. The Proposal Does Not Adequately Address Continuing Concerns About Harm to Liquidity

The Association and its members believe the dissemination scheme set forth in the Proposal may result in harm to liquidity for certain issues. While the Proposal does provide a certain amount of delayed dissemination for large transactions in infrequently traded, lower-rated securities[3], we do not believe it is adequate to preserve the anonymity of large investors in certain segments of the secondary markets and the corresponding willingness of broker-dealers to commit capital to lower credit quality, thinly traded issues. Many of our members feel a dissemination delay of only two to four business days for low-rated, infrequently traded securities is not significant enough to preserve anonymity in the institutional marketplace, and will result in reduced liquidity and reluctance on the part of dealers to commit capital to these issues, ultimately harming investors.

While the Association's representatives on the BTRC actively participated in the development of the current Proposal, it is important to note that they did not unanimously support it. Although they accepted the majority of the Proposal as written, certain aspects remained troublesome and unworkable. The Proposal calls for immediate dissemination of all transactions in BBB-rated securities. Certain of our members believe there is a set of infrequently traded BBB-rated bonds which trade at yields significantly higher than the typical BBB-rated bond—that more properly belong with the infrequently traded BB-

[3] The Proposal contemplates a dissemination delay for large trades (over $1 million) in infrequently traded issues: 2 business days for securities rated BB and 4 business days for securities rated B and below. *See* Proposing Release at 40,430.

rated securities—and should also be disseminated with a two business day delay. This set of securities is relatively small in the current trading environment—and thus will not likely cause great immediate harm to liquidity in the overall markets from implementing the current proposal— however in recent years this set of securities has been much larger. In such a market environment we believe immediate price dissemination for these securities would have harmed liquidity even further.

The Proposal also counts all trades, regardless of size, in determining frequency of trading for a given issue, which in turn dictates whether dissemination for large trades (over $1 million) in low credit quality securities occurs on an immediate or a delayed basis. If a lower-rated security trades very frequently, but only in small denominations, there is still the risk of liquidity being reduced for a very large block trade, the price of which would be immediately revealed under the current Proposal. *We therefore believe it is extremely important to count only large trades (over $1 million) toward determining frequency of trading for a given security under the Proposal.* While we commend the NASD's efforts to establish trading frequency as a criterion for determining dissemination timing on lower rated securities, we do not believe the current Proposal adequately protects liquidity where all trades—regardless of size—are counted toward determining trading frequency.

III. The NASD Should Not Hesitate to Delay Dissemination for Certain Issues Should Liquidity be Harmed

We urge the NASD to closely examine the effects of increased dissemination on liquidity following the effective date of the Proposal, and to seek on an expedited basis appropriate adjustments to the dissemination scheme should harm to liquidity be shown to result for any particular group of securities.

We encourage the NASD to conduct a thorough, ongoing review of relevant transaction and market data to determine exactly how the secondary corporate bond market has responded to greater transparency, and to make practical adjustments to the dissemination scheme to protect liquidity if certain markets are indeed negatively impacted. If harm to liquidity for certain issues results from the increased transparency, the dissemination timing and formula should be adjusted accordingly. As an important part of this ongoing review, the Proposal calls for the BTRC to be reconvened not later than nine months after its effective implementation, for the purpose of reviewing the TRACE rule and making recommendations to the NASD Board of Governors.[4] In addition, a mechanism should be implemented that would enable the BTRC to be convened immediately, should market conditions necessitate. The Association recommends that the BTRC have regular evaluative responsibilities and work in conjunction with the NASD in appraisal of transaction data, market data, as well as relevant independent studies on the emergent effects of dissemination. The members of the BTRC would consist of both buy- and sell-side professionals, specializing in high yield market affairs.

[4] Proposing Release at 40,433.

Finally, we commend the NASD's decision to implement delayed dissemination for large trades in illiquid issues, and encourage the NASD to adopt an ongoing approach of allowing for different dissemination schedules for certain securities and markets.

IV. The NASD Should Make Trade Data Publicly Available To Allow Market Participants to Determine Whether There Has Been A Negative Effect on Liquidity

In the spirit of transparency, the NASD should make its consolidated transaction data publicly available to all market participants, so that the industry can assess firsthand the effects of transparency on liquidity. Data collected following the implementation of the Proposal will be the best and most accurate way to measure the effects of transparency, and whether liquidity was increased or impaired. Making this data freely and readily available to the broker-dealer community which provides it through reporting into the TRACE system should be a priority of the NASD.

Several studies have been conducted in recent months to study the relationship between transparency and liquidity. The results of these studies have been largely inconclusive and have generally showed only statistically insignificant changes in liquidity. As set forth in the Proposal, the NASD commissioned two academic studies to gauge the effects of increased transparency on BBB and lower rated bonds over approximately 18 months, neither of which showed a significant impact, either positive or negative, on liquidity.[5]

Last summer, on behalf of the Association, National Economic Research Associates ("NERA") examined the effect of two separate reductions in the Municipal Securities Rulemaking Board's threshold for next day reporting on the liquidity of small issue and lower rated municipal bonds. NERA conducted an "event study" in which it used regression analysis to analyze the impact of dissemination based on number of trades, lowering the reporting threshold from four trades to three in May 2002 and from three trades to two in December 2002. While the findings were preliminary and results vary by liquidity measure and specification of variables, for instance, how the bond rating groups were defined, there was enough consistency in the regression models to conclude the results were reliable. NERA's preliminary findings subject to further refinement and testing were that "in a number of the regressions, the bond liquidity dropped after the event. In some cases, the results are consistent with an interpretation that the drop in liquidity was greater for bonds of lower issue size".

While results of studies are dependent on the selection and management of variables and other factors which may affect results, the trade reporting data collected following implementation of increased transparency will be the ultimate measure of how liquidity is impacted. This information should be shared openly with all market participants to allow for proper evaluation and consideration of any impact on the markets. We encourage the

[5] Proposing Release at 40,432.

NASD to make this data publicly available to the industry in the spirit of full transparency.

V. Conclusion

We fully support the NASD's goal of increased transparency for the corporate bond markets, and are committed to assisting the NASD in this endeavor by providing corporate bond price information free of charge through our retail investor education website www.investinginbonds.com. However, we continue to have reservations about immediate transparency for certain segments of the market, and feel the delayed dissemination the Proposal calls for is not adequate to fully address our concerns. We urge the NASD to conduct an ongoing review of the effects of increased dissemination for infrequently traded, lower credit quality issues, and to make timely adjustments to the proposed dissemination scheme should harm to liquidity result. Additionally, we urge the NASD to make publicly available to all market participants consolidated trade data to allow for the evaluation and assessment of the effects on liquidity, if any, of increased price transparency.

Should you have any questions or desire any clarification or additional information regarding any of the matters discussed in this letter, please do not hesitate to contact the undersigned, or Michele David, Vice President and Assistant General Counsel of the Association, at (646) 637-9220.

Sincerely,

/s/ Donald R. Mullen, Jr.

Donald R. Mullen, Jr.
Goldman, Sachs & Co.
Chair, Corporate Credit
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cc: ***Securities and Exchange Commission***
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The Bond Market Association

Corporate Credit Markets Division Executive Committee
Corporate Credit Markets Division Legal Advisory Committee
Corporate Credit Markets Division Investment Grade Committee
Corporate Credit Markets Division High Yield Committee
Corporate Credit Markets Division Distressed Debt Committee
Corporate Credit Markets Division Operations Committee
Corporate Credit Markets Division Syndicate Committee