

January 27, 2011

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

Re: File Number S7-34-10
Regulation SBSR -- Reporting and Dissemination of Security-Based Swap Information

Dear Ms. Murphy;

The Financial Industry Regulatory Authority ("FINRA")¹ staff submits this letter in response to the Commission's request for comment relating to Proposed Regulation SBSR -- Reporting and Dissemination of Security-Based Swap Information.² FINRA strongly supports a trade reporting and dissemination structure for security-based swap ("SBS") information. FINRA believes that such a structure and the information it provides, to both market participants and regulators, is vital to maintaining market integrity and investor protection. However, FINRA urges the Commission to consider further mandating the consolidation of SBS information at the time the Commission determines that such data will be disseminated publicly.

FINRA's comments reflect FINRA's experience with the Trade Reporting and Compliance Engine ("TRACE"). FINRA's TRACE rules require the reporting of corporate and agency debt securities transactions in real-time,

¹ As the largest non-governmental regulator for all securities firms doing business with the public in the United States, FINRA oversees nearly 4,700 brokerage firms and about 167,000 branch offices and more than 635,000 registered securities representatives.

Created in July 2007 through the consolidation of NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange, FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complimentary compliance and technology-based services. FINRA has approximately 2,800 employees and operates from Washington, DC, and New York, NY, with 15 District Offices around the country.

The comments provided in this letter are solely those of the staff of FINRA; they have not been reviewed or endorsed by the Board of Governors of FINRA. For ease of reference, this letter may refer to "we" "FINRA" or "FINRA staff" interchangeably, but these terms only refer to FINRA staff.

² See Securities Exchange Act Release No. 63346 (November 19, 2010), 75 FR 75208 (December 2, 2010) (File No. S7-34-10) ("Proposing Release").

and provide for the immediate dissemination of such information to the market. TRACE has significantly increased transparency in these sectors of the bond markets and improved pricing in such markets.³ Since 2002 when TRACE was established, TRACE has been successful as both a repository of data used by regulators to ensure effective and efficient oversight of the bond market, as well as a centralized location where all market participants can access valuable transaction data. The Commission recognized TRACE in the Proposing Release, stating that, “the Commission anticipates that a registered SDR would establish a mechanism functionally similar to one established by TRACE, which is a system operated by FINRA for collecting and disseminating to the public reports of trades in corporate and agency debt securities.”⁴

Proposed Reporting Requirements and Regulatory Oversight

In FINRA’s view, the timely collection and review of transaction data increases market integrity, promotes investor protection and enhances market surveillance. FINRA supports the Commission’s proposal that all SBS transactions be subject to “real-time public reporting”⁵ which is defined to mean “as soon as technologically practicable, but in no event later than 15 minutes after the time of execution of the SBS transaction.”⁶ Given the relationships between various instruments available in the market place today (for example, credit default swaps (“CDS”) and cash bonds), FINRA believes regulators must have timely access to transaction level data for all relevant securities. In our view, the Commission’s Proposal regarding SBSs will make this necessary data available and, consequently, allow for more effective market surveillance and oversight. In addition, transaction data should be reported as soon as practicable after the execution of a SBS transaction. Requiring parties to do so will provide a more accurate data base and enhance transparency. Providing a reasonable but not overly long period to report may eliminate the possibility that counterparties may delay trade reporting for as long as possible (while remaining in compliance with reporting deadlines), altering the order in which transactions appear in regulatory data and are disseminated to the public.

³ In March 2010, TRACE was expanded to collect and disseminate trade data for debt issued by federal government agencies, government corporations and government sponsored enterprises (GSEs), as well as primary market transactions in new issues for both corporate and agency debt. This timely collection of corporate and, more recently, agency transaction data, has enabled FINRA to effectively surveil the market for fraudulent behavior, manipulation, excessive markups and other misconduct that violates federal securities laws and FINRA rules.

On May 16, 2011, TRACE will expand further to include transaction reporting in asset- and mortgage-backed securities. As a result, transaction-level information for trades representing 70 percent of the U.S. debt market will be available (including transactions in municipal securities reported to the Municipal Securities Rulemaking Board), further improving the transparency of the debt markets. Post-trade data will be available for all publicly traded debt securities except money market instruments, U.S. Treasury securities, and foreign sovereign debt instruments.

⁴ See Proposing Release at 75 FR 75251.

⁵ See Proposing Release at 75 FR 75210.

⁶ See Proposing Release at 75 FR 75216.

Transparency

FINRA is also in accord with Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010⁷ which, among other things, seeks “to increase the transparency and efficiency of the OTC derivatives markets,”⁸ and applauds the Commission’s timely proposal to satisfy this directive by requiring the dissemination of transaction information in SBSs. The Commission states in its Release that “post-trade transparency could promote price competition and more efficient price discovery in the SBS market.”⁹ The Proposing Release cites a number of studies providing evidence of the benefits of post-trade transparency, which are based in whole or in part on TRACE data.¹⁰ One study concluded that TRACE has effectively narrowed bid-ask spreads which are widely agreed to be a hallmark of efficient markets.¹¹ Two other studies indicated that TRACE has reduced investor cost significantly (independent studies indicate estimated annual trading cost reductions of nearly \$1 billion for the full corporate bond market);¹² and has contributed to improved valuation precision, reducing the dispersion in valuation between different mutual funds holding the same security.¹³ Lastly, a study of the OTC derivatives market conducted by the Federal Reserve Bank of New York and published in January 2010¹⁴ identifies improvement of “trade level price reporting” as an effective step to improve the OTC derivatives market, and refers to TRACE as evidence of the effectiveness of trade level price reporting and the dissemination of such information as follows:

For example, TRACE, a system for disseminating essentially all transactions prices in the over-the-counter markets for corporate and municipal bonds,¹⁵ was established in 2002. TRACE reports transactions prices after a brief delay, providing investors some insight into the range of prices at which they are likely to be able to execute their next trades. This can

⁷ Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111–203, 124 Stat. 1376 (“Dodd-Frank”).

⁸ See Proposing Release at 75 FR 75208.

⁹ See Proposing Release at 75 FR 75225.

¹⁰ See Proposing Release at 75 FR 75225 (“[A] number of studies of the corporate bond market, for example, have found that post-trade transparency, resulting from the introduction of TRACE, has reduced transaction costs.”).

¹¹ See Edwards, A. K., Harris, L., & Piwowar, M. S., Study, Corporate Bond Market Transparency and Transaction Costs, September 21, 2004.

¹² See Bessembinder, H., Maxwell, W. F., & Venkataraman, K., Study, Market Transparency, Liquidity Externalities, and Institutional Trading Costs in Corporate Bonds, November, 2005.

¹³ See Cici, G., Gibson, S., & Merrick, J. J., Study, Missing the Marks: Dispersion in Corporate Bond Valuations Across Mutual Funds, November 2007(first draft), July 14, 2010 (most recent draft).

¹⁴ See Federal Reserve Bank of New York Staff Report No. 424 – Policy Perspectives on OTC Derivative Markets Infrastructure (“OTC Derivatives Market Study”), http://www.newyorkfed.org/research/staff_reports/sr424.pdf.

¹⁵ As previously stated, TRACE is currently a collector and disseminator of corporate and agency debt transaction data. Collection and dissemination of data in municipal securities is performed by the Municipal Securities Rulemaking Board’s (“MSRB”) Real-time Transaction Reporting System (“RTRS”).

improve the ability of investors, particularly those who are not dealers, to “shop around,” that is, to determine more easily whether to accept the bids and offers quoted to them, and also allows them to better monitor the quality of price execution that they have received on their past trades.¹⁶

There has been no observed loss of liquidity since the launch of TRACE or after the dissemination of last sale information was adopted as the general policy for all debt securities transactions that are currently reported to TRACE. During the roll-out of TRACE, one study indicated that the increased post-trade transparency had a neutral or positive effect on liquidity for BBB-rated corporate bonds.¹⁷ Given the positive effects of transparency on the corporate debt market, FINRA supports the Dodd- Frank mandate “to make security-based swap transaction and pricing data available to the public in such form and at such times as the Commission determines appropriate to enhance price discovery,”¹⁸ and approves the Commission’s proposal to carry out their duty to mandate that SBS transaction information be made available to the marketplace.

Implementation and Disseminated Data

FINRA supports the Commission’s proposal for staggered implementation and its consideration as to how and when such data should be disseminated to the public. The Proposing Release notes that the responsibility of a swap data repository (“SDR”) to disseminate certain SBS transaction reports to the public would begin nine months after the effective date of Proposed Regulation SBSR, and, thereafter, would be phased in for all SBS over the next nine months.¹⁹

FINRA similarly implemented the public dissemination of last sale transaction information for transactions reported to TRACE in phases based on liquidity, starting with the largest, most liquid, issues first and completing the implementation in January 2006.²⁰ FINRA believes that phasing in dissemination ensures a

¹⁶ OTC Derivatives Market Study.

¹⁷ See Goldstein, M. A., Hotchkiss, E. S., & Sirri, E. R., Study, Transparency and Liquidity: A Controlled Experiment on Corporate Bonds, July 1, 2006.

¹⁸ See Dodd-Frank, Pub. L. No. 111–203, 124 Stat. 1376, 1779.

¹⁹ See Proposing Release at 75 FR 75210 (“Section 13(m)(1)(E) of the Exchange Act requires that the Commission’s rule providing for the public availability of SBS transaction data contain provisions to: (1) ensure that such information does not identify the participants; (2) specify the criteria for determining what constitutes a large notional SBS transaction (block trade) for particular markets and contracts; (3) specify the appropriate time delay for reporting large notional SBS transactions (block trades) to the public; and (4) that take into account whether public disclosure will materially reduce market liquidity.”).

²⁰ FINRA phased in dissemination by starting with the largest, most liquid issues and, generally, the most highly-rated issues, then began to incorporate additional bonds in phases, based generally on their credit rating, making more highly rated bonds subject to dissemination before lower-rated bonds. Phasing in dissemination was completed in January 2006. Currently, through TRACE, real-time, public dissemination of transaction and price data for all publicly traded corporate bonds occurs – including intra-day transaction data and aggregate end-of-day statistics (most active bonds, total volume, advances and declines and new highs and lows). TRACE currently disseminates transaction level data in real-time, capping those transactions which meet FINRA’s designated thresholds to ensure that liquidity for the largest trades are not reduced because of transparency (size is capped at \$5 million for corporate investment grade and agency debt securities, and \$1 million for high yield debt securities).

more orderly transition that minimizes the likelihood of market disruptions and an unintended loss of liquidity. Additionally, phased-in dissemination provides participants, both investors and traders, adequate time to adjust to a market with real time SBS transaction data. A phased-in approach to dissemination also provides regulators with the ability to assess the impact of transparency on the market and, if necessary, to make adjustments to both the timing of dissemination and the data that should be disseminated. FINRA supports the Commission's proposed dissemination structure.

Consolidation of Data

As noted above, FINRA strongly supports bringing transparency to the SBS market. FINRA agrees with the Commission's view that "requiring registered SDRs to be the registered entities with the duty to disseminate information would produce some degree of mandated consolidation of SBS transaction data and help to provide consistency in the form of the reported information."²¹ However, if multiple SDRs do emerge, FINRA urges the Commission to consider further mandating the consolidation of disseminated SBS data to the public.

FINRA recognizes the Commission's acknowledgement of "the possibility that there could emerge multiple registered SDRs in an asset class,"²² and, in the event this should occur that "the Commission and the markets would be confronted with the possibility that different registered SDRs could adopt different dissemination protocols, potentially creating fragmentation in SBS market data."²³ While the Proposing Release does note that "the proposal would not prohibit registered SDRs that cover the same asset classes from acting together to create a central consolidator that would disseminate information for all SBSs in that asset class,"²⁴ FINRA believes any further steps taken by the Commission to mandate the consolidation of public SBS transaction data will only help to ensure uniformity and, as a result, help to promote market integrity and investor protection. In addition, FINRA believes that the central consolidator or the Commission must have the regulatory authority to compel all participants, including SDRs, to submit the data to help ensure that there is one, comprehensive, and accurate source for this data.

Aggregate View of Marketplace

Finally, FINRA favors the Commission's proposal because, based on FINRA's experience with TRACE, FINRA believes that the collection and review of transaction level data is necessary to obtain an accurate view of and insight into the SBS market. TRACE has revealed facts and figures about a marketplace where previously no aggregate view was available. After FINRA obtained and reviewed

With the expansion to capture and disseminate agency debt in March 2010, TRACE currently captures and disseminates transaction information in over 45,000 eligible securities from 2,000 FINRA-regulated firms registered to trade eligible bonds. This data is available through all major market data vendors and on certain public websites. Currently, over 50,000 professionals use the data, and free access is available to retail investors through FINRA's website. As a result, FINRA not only recognizes the importance of transparency, but also the significance of how and when such data is disseminated to the public.

²¹ See Proposing Release at 75 FR 75227.

²² See Proposing Release at 75 FR 75227.

²³ See Proposing Release at 75 FR 75227.

²⁴ See Proposing Release at 75 FR 75227.

TRACE data, many long-held assumptions regarding the OTC bond market proved inaccurate or incomplete. For example, dealer participation is less concentrated than was anticipated; retail investors are much more active than was commonly thought; and, a broader range of securities trade more actively than most industry participants predicted. FINRA also makes such aggregate market information available to market participants and the public in the FINRA TRACE Fact Book.²⁵

Similarly, we believe the Commission's proposal will provide significant insight into the scope and dynamics of the SBS market place. Obtaining data, especially transaction level information, about the market will ultimately provide for a broader and more complete risk assessment, a regulatory frame work based on accurate information and improved market surveillance. FINRA believes that transparency can be most efficiently achieved through a single consolidator of data.

In Summary

In its almost nine years of existence, TRACE has provided the marketplace and regulators with invaluable insight into the corporate bond, and more recently, the agency debt markets (except asset-backed securities). It has provided investors with crucial price information, making real-time data available to over 50,000 market professionals, and has provided regulators with essential information for oversight and surveillance which helps to ensure the market integrity necessary for investor protection. Today, few in the market place would act before consulting the transaction information available from TRACE.

Given FINRA's experience with TRACE as a vehicle for the collection and dissemination of transaction data, along with the benefits that these functions have afforded the OTC marketplace and its investors, FINRA is fully in favor of enhancing regulatory surveillance and market transparency and, therefore, strongly supports a trade reporting and dissemination structure for SBS information.

Sincerely,



Richard G. Ketchum

²⁵ The FINRA TRACE Fact Book, which is published annually, is available at FINRA's website www.FINRA.org. In 2009, FINRA also began to include quarterly updates to its TRACE Fact Book.