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April 19, 2005

Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1500

Re: Comments on Draft Rule 2231

Dear Ms. Sweeney:

As you know, John Ladensack¹ from Charles Schwab & Co., Inc. ("Schwab") was a member of the Corporate Debt Market Panel (the "Panel") that laid out the framework of recommendations for ensuring market integrity and investor protection in the corporate bond market. Schwab continues to strongly support the Panel's goal of helping individual investors make more informed decisions about corporate bond investments by improving access to information. In fact, many of the Panel's recommendations have been long-standing practices at Schwab.

In its September 2004 report, the Panel recommended that individual investors have access to relevant information at three distinct points in the investment process, namely: (1) when expressing an interest in investing in corporate debt; (2) at the point of purchase or sale; and (3) on the post-sale regulatory confirmation. While we appreciate the NASD's efforts to translate the Panel's recommendations into a set of governing rules, we are disappointed that proposed Rule 2231 focused exclusively on the post-sale regulatory confirmation. We believe

¹ John Ladensack is no longer associated with Schwab. Jim White, Senior Vice President of Fixed Income Trading has assumed many of Mr. Ladensack's duties, and serves as Schwab's representative with regard to the corporate bond market.

that of the three points of disclosure identified by the Panel, the post-sale regulatory confirmation is the most expensive to implement and provides the least benefit to individual investors. Schwab opposes Rule 2231 because:

- Important information relevant to the investment decision will not be provided until after the point of purchase or sale;
- Confirmations required by SEC Rule 10b-10 should be transactional in nature and not burdened with information better suited to the point of purchase or sale; and
- Any limited benefits from post-sale disclosures would not justify the substantial costs required to implement proposed Rule 2231.

Schwab recommends that the NASD reconsider the recommendations of the Panel and work with the industry to find ways to make this important information available to an individual investor at or before such investor makes an investment in corporate debt.

I. Individual Investors Should Have Access to Educational Content Before Making an Investment Decision in Corporate Debt.

Schwab recommends that the NASD focus on ensuring that individual investors are provided with the educational material when most useful and relevant. Rather, than create a new hybrid regulatory disclosure obligation unique to corporate debt transactions, Schwab would instead recommend that the NASD borrow from the approach adopted for sales of Collateralized Mortgage Obligations (“CMOs”).

In 1993, the NASD had similar concerns with the complexity of CMOs and mandated that members take steps to ensure their customers were fully educated about CMOs. Accordingly, the NASD proposed, and SEC approved, amendments to the NASD’s rules requiring members to offer investors an educational document or other material about CMOs. This rule relating to CMO educational content is set forth today in IM-2210-8(2).

A similar rule could readily be crafted for corporate debt securities. Educational material could be offered in a manner most relevant to the nature of services provided by the member firm – whether verbally in direct conversations with registered representatives or as material posted on a member’s website in the context of self-directed investors. We think the NASD should also allow member firms the flexibility to craft their own content as provided under the CMO disclosure rule.

We believe this approach is a better alternative than the one proposed under Rule 2231 because it ensures that the educational material is provided to individual investors at a time when such investors would consider the material useful. This approach also avoids the unnecessary expense of printing, maintaining and mailing educational material to investors who would otherwise not consider the material to be relevant or of value.

II. Without a Corresponding Benefit, New Post-Trade Disclosures Would Be Too Costly

Schwab is deeply concerned about the substantial costs member firms will incur in order to comply with the confirmation requirements of proposed Rule 2231. Proposed Rule 2231 will require systems changes that extend far beyond upgrades to the functionality of a member firm's trade confirmation systems. Proposed Rule 2231 will also require changes in functionality of other systems within member firms to ensure that data necessary to calculate the required disclosures is collected and appropriately archived. Complex programming would be required to ensure accurate communication of data between various system databases and each member firm's trade confirmation systems. Each member firm would then need to conduct extensive testing on the affected systems because failure to accurately provide the information on the trade confirmation would result in regulatory violations and expose the member firm to substantial financial liability. Most importantly, each member firm would need to create entirely new back-up systems for each database or other system that is relied upon to help provide the required disclosures. This means that member firms would have to establish redundant systems for currently non-critical systems so that, in the case of system downtime, the member firm could continue to meet its trade confirmation obligations under proposed Rule 2231.

Schwab also believes that the ongoing annual costs associated with proposed Rule 2231 are not justified. The required disclosures will add substantial space requirements to the trade confirmation. Member firms may also need to include additional terms and conditions, as well as other disclosures to ensure that the trade confirmation is not misleading. It appears that these disclosures would extend the length of most confirms to at least two pages, substantially increasing mailing costs and, thus, overall on-going annual costs of trade confirmations. Depending upon formatting requirements, these changes to confirmations may require member firms to replace existing mailing equipment to accommodate the increased size of the confirmation.

III. Comments on the Exclusions for Institutional Investors

We also agree with the Panel's conclusion that there is little benefit in providing such material to institutional investors. For purposes of this exception, however, we do not believe that either the definition of "institutional investor" under NASD Rule 2211(a) (3) or the definition of "qualified purchaser" under Section 2(a) (51) of the Investment Company Act of 1940 is sufficiently broad. The NASD should clarify that the obligation to provide or not provide this educational material runs to the fiduciary authorized to execute trades in an individual investor's account, and not to the beneficial owner. In other words, the educational content should be offered to the fiduciary, to the extent the fiduciary would not otherwise qualify for the institutional investor exception.

IV. Comments on the Effective Dates of Proposed Rule 2231

The NASD did not provide a proposed effective date for proposed Rule 2231. If the NASD were instead to focus on requiring access to educational material and improving the information available at the point of sale or purchase, we believe that member firms would need no more than six-months to comply. In contrast, if proposed Rule 2231 were adopted with out modification, Schwab believes that, depending upon the complexity of systems changes, member firms would need at minimum 12 to 18 months to plan, make and test the necessary changes to their trade confirmation systems.

Further, the implementation of disclosure requirements should be uniform. Proposed Rule 2231 seems to contemplate different disclosure obligations based upon what subscriptions a member firm may maintain with an NRSRO. Because these subscriptions are expensive, such a rule would create an unintended incentive for firms to make less information available, rather than more. There is also a fundamental unfairness in requiring responsible firms that do maintain such subscriptions to incur incremental implementation costs to comply with a mandated disclosure obligation, but allowing other firms to avoid all costs altogether. If the information needs to be disclosed to “best ensure market integrity and investor protection in the corporate bond market,” then the disclosure obligation must be applied uniformly across all member firms.

Lastly, before any rule is implemented, the NASD and the industry must consider and address the fact the processes for trading corporate debt instruments differ between the over-the-counter market and the New York Stock Exchange. As a result of these different processes, we believe many firms may use separate technology platforms for each. These different processes will greatly impact the complexity of making changes to a firm’s trade confirmation system.

V. Conclusion

Schwab is disappointed that proposed Rule 2231 is silent on the issue of improving access to information before and at the time of buying or selling corporate bonds. We believe that requiring such access is a necessary and essential component of any rule designed to help individual investors make more informed decisions about corporate bond investments. Because most of information that should be accessible to individual investors is already available on the systems of member firms, we believe requiring access to information at the critical point of purchase or sale could be implemented relatively quickly.

We acknowledge that cost alone should not determine the manner in which important disclosures are made available to investors. However, since these costs will ultimately be borne by investors, we urge the NASD to carefully consider whether proposed Rule 2231 is the most effective and efficient method of providing access to information. As discussed above, Schwab believes that there are more effective and less costly methods to make this important material available to individual investors. We believe that the post-sale regulatory confirm should be reserved to its regulatory function of documenting and verifying transactions.

Schwab is willing to work with the NASD on crafting a more effective disclosure model. If you have any questions, please do not hesitate to contact Jim White at 415 557-5051 or Andrew Epstein at 415 667-5820.

Sincerely,

/s/
Jim White
Senior Vice President
Charles Schwab & Co., Inc.

/s/
Andrew Epstein
Director, Fixed Income Compliance
Charles Schwab & Co., Inc.

cc: Maurisa Sommerfield
Michael Alexander
George Vonzedlitz