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
Telephone 44.20.77 43 93 00
Fax 44.20.77 43 93 01

April 20, 2005

THE BOND MARKET ASSOCIATION

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

Re: NASD Notice to Members 05-21: Proposed Rule 2231 Regarding Confirmation Disclosure in Corporate Debt Securities Transactions

Ladies and Gentlemen:

The Bond Market Association (the "Association")[1] appreciates this opportunity to comment on the above-referenced Notice to Members (the "Notice") of the National Association of Securities Dealers, Inc. (the "NASD"). The Notice requests comment on proposed Rule 2231, which would require members to provide additional disclosures in connection with certain retail transactions in corporate debt securities. Proposed Rule 2231 is based on the September 2004 Report (the "Report") of the Corporate Debt Market Panel (the "Panel"), which was convened by the NASD to review and make recommendations to the NASD regarding market integrity and investor protection in the corporate bond market.

The Association welcomes and supports the NASD's recent initiatives to help improve investor education in the corporate bond market. For many years, the Association has been at the forefront of efforts to enhance investor education with respect to fixed income securities such as corporate bonds.[2] We therefore fully support the principle underlying the Panel's Report and proposed Rule 2231 – that as retail investors

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[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*.

[2] For example, our "Investor's Guides" and related publications available on our website provide concise, easy to understand explanations of different types of fixed income products, including corporate debt securities, as well as risks and other factors investors should consider before investing in these products. In addition, our highly-acclaimed website geared towards investors, *www.investinginbonds.com*, and the other investor-oriented websites of The Bond Market Foundation (*www.tomorrowsmoney.org*, *www.ahorrando.org*, and *www.unwantedchange.org*) reflect our ongoing interest in and support for retail investor education.

become more active in the corporate debt market, it is important to take steps to ensure they have timely access to information that is necessary for them to make informed investment decisions.

The Association has concerns, however, about whether proposed Rule 2231 strikes an appropriate balance between the potential benefits of additional confirmation disclosure and certain competing considerations, such as the costs and operational difficulties of providing additional confirmation disclosure, the existence of alternative means and materials for making the relevant information available to investors, and the need to ensure disclosures adequately capture the nuances and complexities of the relevant securities.

In Part I below, we summarize certain general comments and principles that we believe must be considered in reviewing the requirements of proposed Rule 2231. In Part II below, we offer more detailed comments on the specific disclosure requirements under proposed Rule 2231. In Part III below, we urge that *www.investinginbonds.com*, rather than the proposed brochure prepared by the NASD (the "Brochure"), be used to provide educational information to retail investors. The Association would welcome the opportunity to discuss these comments with the NASD and to engage in an ongoing dialogue regarding the appropriate means for improving retail investor education in the corporate debt market, including disclosure and investor education initiatives that go beyond transaction confirmations.

I. General Comments Regarding Proposed Rule 2231.

The following general points underlie many of our specific comments on Rule 2231 in Part II below.

- *Expanding or Modifying Confirmation Disclosure Involves Significant Systems and Operational Costs and Issues.* Changes or additions to confirmation disclosures may entail substantial and costly modifications and upgrades to current systems and operational procedures. For many firms, significant coordination with third-party service providers who support the generation and delivery of confirmations will be required. These burdens may be especially onerous for smaller, retail-oriented firms – including firms that provide important liquidity to retail investors in the corporate debt markets. In addition, there are practical constraints on the amount of additional information that can be included in a confirmation or the specific form in which such information is presented.

As has been recognized by the Securities and Exchange Commission (the "SEC"),[3] these practical considerations must be taken into account in any proposal for additional confirmation disclosure. It is particularly important that Rule 2231 provide maximum *flexibility* for firms to convey required information in a manner that is consistent with their unique systems and operational environments – rather than mandating overly-prescriptive and specific forms of disclosure that may be impractical for some firms to implement. Greater flexibility will also facilitate the ability of firms to provide the disclosure that is most appropriate for the particular product or transaction.

In addition, even if our recommendations below are adopted, we expect firms will need a very substantial period of time (*i.e.,* at least a year) to make the systems modifications necessary to implement Rule 2231.

- *"Back of Confirmation" Disclosure Should Be Presumptively Permitted.* A specific operational issue with important implications for Rule 2231 relates to the manner in which information is currently presented on confirmations. Although each firm's systems are unique, many firms currently provide confirmation disclosure either on the "front" or the "back" of the confirmation. The "front" of the confirmation typically contains transaction-specific terms – such as the security description, the price, the yield, the settlement date, etc. The "back" of the confirmation typically includes certain contractual language and disclosures that are more "generic" and do not vary from transaction to transaction.

  Current systems of many firms substantially limit the number of new "fields" that can be added to the "front" of the confirmation and the space for additional text in such fields. In order to reduce unnecessary costs and burdens on broker-dealers, required disclosures under Rule 2231 should be permitted to be made whenever appropriate in a "generic" form on the "back" of the confirmation – rather than in a form that must change for each transaction or that otherwise must be presented on the "front" of the confirmation. The NASD should also

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[3] The SEC stated in Release 34-33743, 59 Fed. Reg. 12767, 12772 (Mar. 17, 1994):

> In amending Rule 10b-10, the Commission must balance the increased cost to broker-dealers, and ultimately to investors, of compliance against the benefits that added disclosures would provide investors. In some instances, the Commission has declined to adopt proposed amendments to its confirmation requirements because they were considered too costly, or would have been too difficult to apply on a uniform basis. [Footnote omitted.]

make it clear that disclosure on the "back" of the confirmation is acceptable unless the Rule explicitly provides otherwise.[4]

- *Rule 2231 Should Not Duplicate Disclosures Required Under Rule 10b-10.* Although proposed Rule 2231 states that it does not require disclosure that would duplicate Rule 10b-10,[5] certain key areas of disclosure (such as yield to maturity and call features) are currently addressed by Rule 10b-10. In our view, Rule 10b-10 has already struck a balance between the desirability of more detailed disclosure and the practical considerations associated with providing that additional detail. Where Rule 2231 addresses topics already addressed by Rule 10b-10, there must be a more compelling explanation of the need to restrike this balance.

- *Rule 2231 Must Exclude or Accommodate Certain Non-Traditional Corporate Bonds.* Proposed Rule 2231's disclosure requirements and the Brochure's description of corporate bonds generally do not address certain more specialized or structured products – *e.g.*, bonds that are mandatorily exchangeable for securities or that are otherwise "equity-linked" in nature. We have identified and described below a number of circumstances involving these special types of corporate bonds in which Rule 2231's requirements are not currently workable. Rule 2231 should be modified to exclude such bonds from its scope or to accommodate the unique issues they raise.

- *Rule 2231 Should Build on the Educational Information Available at www.investinginbonds.com.* The Association's website already provides comprehensive educational and other information to investors. We therefore do not believe it is necessary or appropriate for the NASD to refer investors to its own website and mandate the industry's use of the new Brochure. We propose instead that firms be required to refer investors to *www.investinginbonds.com*

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[4] Proposed Rule 2231 would permit firms to deliver information on a piece of paper (or electronic communication) that is separate from that used for the trade confirmation required under Rule 10b-10. Although the opportunity for such separate disclosure might at first appear to alleviate the systems issues associated with expanding disclosures on trade confirmations (and the option to provide separate disclosure should be preserved), in most cases this simply will not be a practical alternative. In the experience of our members, investors do not want to receive separate pieces of paper for each securities transaction, and may very well be confused by or ignore multiple pieces of paper sent for the same transaction – which obviously would frustrate the fundamental objectives of Rule 2231. In addition, there are important operational and systems issues and costs associated with developing and delivering a separate disclosure document for each trade.

[5] Proposed Rule 2231 states that "A member need not disclose to customers information required to be disclosed under this Rule if the member will disclose such information pursuant to Rule 10b-10 under the Act." *See* Part II.C.1 below, in which the Association seeks clarification as to the meaning of this statement.

for educational information, and that they also be permitted to refer to this website in lieu of providing certain other information required by proposed Rule 2231.

II. Specific Comments on the Detailed Requirements of Proposed Rule 2231.

A. Exclusion of "Institutional Customers."

Proposed Rule 2231 would not apply to transactions with persons that are "institutional customers," a term defined by reference to the term "qualified purchaser" in Section 2(a)(51) of the Investment Company Act of 1940 (the "Investment Company Act"). We believe that this method of distinguishing "institutional" from "retail" transactions would impose significant burdens on firms simply in order for them to determine whether or not the Rule applies to a particular transaction. We propose several modifications to alleviate this burden.[6]

1. Exclude Accounts Managed by a Broker-Dealer or an Investment Adviser. Transactions by accounts that are managed by an investment adviser,[7] broker-dealer or other fiduciary should be exempt from the requirements of Rule 2231.[8] There is simply no need to provide the additional disclosures mandated by Rule 2231 to these accounts, since their owners rely on the broker-dealer, adviser or fiduciary to make appropriate investment decisions on their behalf[9] and these investment professionals have the ability and sophistication to access independently the types of information covered by Rule 2231.

In addition, in connection with accounts managed by a third-party adviser, it may be very difficult or impossible for member firms to obtain sufficient information

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[6] We emphasize that the proposed modifications below are not mutually exclusive. To the contrary, in our view the systems and related implementation burdens on firms will be reduced if firms have more options for defining the category of accounts covered (or not covered) by the Rule, even if those options overlap to some extent.

[7] Accounts managed by an investment adviser should be excluded if the investment advisor is registered with the SEC or a comparable state agency, or is exempted from registration.

[8] Section (a)(1) of Rule 2231 states that "Any member that is required to disclose to a customer information pursuant to Rule 10b-10 under the Act in connection with any transaction in a debt security also shall disclose to the customer the information set forth in paragraph (b)." Although this sentence may have been intended to provide an exclusion for managed accounts or otherwise to incorporate any no-action or other relief from delivering confirmations under Rule 10b-10, we believe that more explicit guidance on this point is necessary.

[9] *Cf. Cleary, Gottlieb, Steen & Hamilton* (Nov. 2, 2004) at question 21 (regarding treatment of advised accounts under the global research settlement).

regarding the investor to determine whether transactions with that investor are subject to Rule 2231. In many cases, investment managers that act for discretionary accounts may not permit the broker-dealer to communicate directly with the holders of such discretionary accounts. Indeed, it is for this reason that the staff of the SEC has provided no-action advice establishing procedures pursuant to which confirmations may be delivered to the account holder's custodian or, in some cases, to the investment adviser or other fiduciary authorized to manage the account (rather than to the account holder).[10] If no confirmation is required to be delivered to the investor, there is no rationale for requiring additional, retail-oriented disclosure in that confirmation.

2. *Exclude DVP Accounts and Prime Brokerage Accounts.* DVP and prime brokerage accounts generally involve sophisticated customers that have substantial assets and are able to establish custodial relationships with a bank or broker-dealer.[11] Although many of these accounts would likely qualify as "institutional customers" under the current definition in Rule 2231, an explicit exemption from the Rule for such accounts would simplify compliance and avoid unnecessary confusion.[12] In addition, we note that application of the Rule to DVP and prime brokerage accounts would raise a number of additional implementation issues. For example, many firms use the DTC-ID confirm system for confirmations with DVP accounts, and it is not clear that this system would presently accommodate the additional disclosures that would be required by Rule 2231.

3. *Replace the "Qualified Purchaser" Standard with a More Straightforward Asset Test, and Clarify How Any Asset Test Will Be Applied.* As noted above, proposed Rule 2231 generally would incorporate by reference the "qualified purchaser" definition from the Investment Company Act. We propose that Rule 2231 use a more straightforward asset test.

The "qualified purchaser" definition in Section 2(a)(51) of the Investment Company Act, together with related Rules 2a51-1 and 2a51-2, provide fairly detailed and complex guidelines for applying the definition, including rules for determining beneficial interest and measuring a customer's "investments."[13] We appreciate the NASD's efforts to find a workable definition of "institutional customer," and believe that in principle the

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[10] *Public Securities Association* (Sept. 29, 1995).

[11] Indeed, prime brokerage accounts are subject to substantial minimum equity requirements. *Prime Brokerage Committee* (Jan. 25, 1994).

[12] *Cf. Cleary, Gottlieb, Steen & Hamilton* (Nov. 2, 2004) at question 23 (regarding treatment of prime brokerage accounts under the global research settlement).

[13] These guidelines obviously were developed for the somewhat different purpose of determining which investors may invest in a vehicle that qualifies for the exemption from Investment Company Act registration under Section 3(c)(7).

asset threshold established in the "qualified purchaser" definition for natural persons may be appropriate for individual investors. We are concerned, however, that the development of appropriate systems and procedures for assessing whether each customer is a "qualified purchaser" will entail significant initial and ongoing expenses – especially since at present firms generally use this definition only in limited circumstances (when customers are investing in an entity relying on their "qualified purchaser" status). For purposes of including an asset-based test in Rule 2231, we urge the NASD to consider using a more straightforward definition without incorporating Section 2(a)(51) in all its complexity. We recognize the challenges posed by identifying an appropriate definition and would be pleased to discuss this matter further with the NASD.

Regardless of the asset test used under Rule 2231, the NASD should clarify the timeframes and manner in which firms would measure a customer's assets. It would be extremely onerous to require firms to determine whether an investor satisfies a particular asset threshold in connection with each transaction, especially since the investor may custody few or no assets at the broker-dealer and the broker-dealer therefore must rely on information provided by the investor.[14] The Association proposes that firms be permitted to determine whether an investor satisfies any asset threshold requirement once, when the investor establishes an account with the broker-dealer, or on a periodic basis. In addition, for these purposes firms should be permitted to rely in good faith on information or representations provided by the investor.

4. Exclude Transactions in Excess of a Certain Dollar Amount. Rule 2231 should also exclude from its scope transactions above a certain dollar value that would be established with the objective of distinguishing between "retail" and "institutional" transactions for purposes of the Rule. This approach would be consistent with the Panel's Report, which reviewed the degree of individual participation in the corporate bond markets and noted that transactions of $100,000 or less in value were "widely viewed as representative of *individual investor* activity" (emphasis added).[15] Although it may be appropriate to set the threshold higher than $100,000 – to ensure that retail transactions are adequately captured – this proposed exclusion would help simplify and clarify the circumstances in which Rule 2231 applies.

5. Consider Other Means of Simplifying the Determination of Whether Rule 2231 Applies. We urge the NASD to consider additional means to enhance the ability of firms to use their current systems to readily determine whether the Rule applies to a

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[14] By way of example, firms typically determine whether an investor is a "qualified purchaser" by receiving appropriate representations from the investor at the time the investor purchases interests in an investment vehicle relying on Section 3(c)(7). It obviously would not be practical to obtain such representations in connection with every debt securities transaction.

[15] Report at 4.

particular transaction, and to limit the application of the Rule where it is unnecessary. For example, it may be appropriate to exclude from the Rule non-natural persons (*i.e.*, customers that firm systems could readily identify as having a tax identification number),[16] investors whose trading activity has exceed a certain threshold over a defined period, or employees of a broker-dealer or investment adviser. Other approaches may also be available; the Association would be pleased to discuss this important issue further with the NASD.

B. Securities Subject to Rule 2231.

Proposed Rule 2231 would apply to *any* debt securities other than "exempted securities" and "asset-backed securities." In our view, Rule 2231 should be limited to transactions in TRACE-eligible debt securities.[17] The Panel did not consider or address transactions in other types of debt securities[18] and it is not clear why other securities are included in proposed Rule 2231.[19]

Limiting Rule 2231 to TRACE-eligible securities would provide significant operational advantages for firms.[20] Broker-dealer systems already generally track whether a security is TRACE-eligible for purposes of compliance with TRACE trade reporting

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[16] We note that the Panel's Report focused on the need for additional disclosures to "individuals" and "individual investors;" it did not review or address the need for additional disclosures to smaller institutional investors, and we are not aware of any other reports or studies that have identified a need for such institutional investors to receive enhanced disclosures. If the NASD believes that there may be a basis for requiring such additional disclosure to these institutions, it may be appropriate to solicit the recommendations of the Panel once it reconvenes. (The Panel's Report noted that "[t]he Panel will reconvene in nine months to discuss developments in this market." Report at 11.)

[17] As described in greater detail in Parts II.H, II.I and II.J below, certain types of debt securities raise special issues when describing the frequency of interest or principal payments, calculating yield or identifying call features. The Association recommends that these securities also be excluded entirely from Rule 2231, or at a minimum, from certain cash flow information requirements of Rule 2231.

[18] "The discussions [of the Panel] were limited to TRACE-eligible securities that trade in the U.S. secondary corporate bond market, including investment grade, high-yield and convertible bonds." Report at 4.

[19] If the NASD believes that additional disclosures may be necessary in connection with non-TRACE-eligible securities, this issue and related implementation concerns could be raised with the Panel when it reconvenes. In assessing the need for applying Rule 2231 to transactions in non-TRACE-eligible securities, it would be especially important to take into account the level of retail investor participation in the markets for such securities.

[20] As discussed in Part II.G below, many questions arise as to how a firm will determine whether price information is "publicly available" in connection with non-TRACE-eligible securities, and if such information is publicly available, whether it is available "for the customer's non-commercial use at no charge." Limiting the Rule to TRACE-eligible securities will eliminate this problem.

requirements. A requirement that firms provide the proposed disclosures for *other* types of debt securities would entail systems changes to identify and track a new category of securities – securities that are "debt securities" as defined in Rule 2231, but not "exempted securities" or "asset backed securities" – that would be used solely for purposes of complying with Rule 2231.[21]

C. Interaction With Rule 10b-10.

We request that the NASD clarify the interaction of Rule 2231 with the requirements of Rule 10b-10 in several respects.

1. Clarify the Overlap With Requirements of Rule 10b-10. Proposed Rule 2231 states that "[a] member need not disclose to customers information required to be disclosed under this Rule if the member will disclose such information pursuant to Rule 10b-10 under the Act." The meaning of this statement is unclear. One reading is that where Rule 10b-10 requires the disclosure of a certain type of information (*e.g.,* yield or commission amount), the corresponding requirement of Rule 2231 (*e.g.,* yield to maturity or stating "you paid a commission") would not apply. If this reading is correct, however, then the provisions of proposed Rule 2231 that relate to information already disclosed under Rule 10b-10 are duplicative and should be deleted.[22]

2. Conform Rule 2231 to Confirmation Requirements for Wrap Fee Programs. Proposed Rule 2231 should be modified to ensure consistency with exemptive relief that has been granted by the SEC to broker-dealers sponsoring "wrap fee" programs.[23] In general, this relief permits broker-dealers to send periodic account statements to customers in lieu of trade-by-trade confirmations. The NASD should clarify

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[21] If our recommendation to limit Rule 2231 to TRACE-eligible securities is not accepted, the NASD should clarify an ambiguity in the current definition of "debt security," which refers to the "meaning" of that term in Rule 10b-10. The definition of "debt security" in paragraph (d)(4) of Rule 10b-10 applies only for purposes of paragraphs (a)(3), (a)(4) and (a)(5) of Rule 10b-10. Thus, it is unclear whether the term "debt security" under proposed Rule 2231 has the meaning for purposes of paragraphs (a)(3), (a)(4) and (a)(5) of Rule 10b-10 or the meaning for purposes of the other paragraphs of Rule 10b-10.

[22] Proposed Rule 2231 generally requires information to be disclosed "in the same manner in which the member discloses to the customer information in connection with the transaction pursuant to Rule 10b-10." The Notice clarifies, however, that the Rule 2231 information need not be included on the same piece of paper (or electronic document) as the Rule 10b-10 confirmation. This clarification should be incorporated into Rule 2231.

[23] *See, e.g., Goldman Sachs & Co.* (Aug. 14, 2003); *Money Management Institute* (Aug. 23, 1999); *Advest, Inc.* (July 19, 1999); *Scudder Investor Services* (Feb. 11, 1998); *Donaldson, Lufkin & Jenrette* (Aug. 21, 1997).

that under these circumstances Rule 2231 would *not* require transaction–specific disclosures at the time of the trade.[24]

D. Disclosure of Debt Security Information.

Proposed Rule 2231 requires disclosure of the debt security's CUSIP and, if it is a TRACE-eligible security, the TRACE symbol of the debt security (if one has been designated by the NASD).

In our view, further consideration must be given to the usefulness of reporting a TRACE symbol in addition to the CUSIP number. The Panel noted that it "does not believe that CUSIP is appropriate for individual investors," but it did not propose disclosure of the TRACE symbol. Instead, it recommended that "NASD should conduct a study to determine if its TRACE symbol has appropriate user-friendly characteristics to meet this need or whether an alternative should be developed."[25] We are not aware of any such study having been conducted. There are significant questions about whether the TRACE symbol is any more "user-friendly" than a CUSIP, especially for entities that issue many bonds that have similar symbols – *e.g.*, pursuant to a medium-term note program. In addition, we note that it is not necessary for investors to have both the CUSIP and a TRACE symbol, since we understand that either identification will allow them to access available price information (including through www.nasdbondinfo.com). At a minimum, firms should be permitted to elect between these two symbols in light of their own systems considerations.

E. Disclosure of "Brokerage Charges."

1. Eliminate the "Brokerage Charges" Disclosure for Agency Transactions. Under proposed Rule 2231, if a firm acted as agent for a customer and received or will receive remuneration that would be required to be disclosed under Rule 10b-10, the firm must disclose to the customer in a text field labeled "brokerage charges" that "you paid a commission to our firm for its services."

This "brokerage charges" disclosure for agency transactions is unnecessary and should be eliminated. The requirement would apply only when the existence and amount of the remuneration from the customer are required to be disclosed under Rule

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[24] In addition, under this exemptive relief for wrap accounts broker-dealers are not required to include in their periodic reports to investors certain information regarding compensation, yield and ratings that is otherwise required by Rule 10b-10. The NASD should clarify that, by the same rationale, the periodic reports for such accounts do not need to include comparable information regarding compensation, yield and ratings otherwise required by Rule 2231.

[25] Report at 13.

10b-10 and therefore would not provide any additional information to the customer.[26] If the NASD nevertheless seeks to require that commission information be labeled as such, at a minimum it should provide firms with flexibility to do so in a manner most appropriate to their systems and circumstances.

2. *Revise the "Brokerage Charges" Disclosure Requirements for Principal Transactions.* Proposed Rule 2231 would require a firm that, acting as principal, purchased a debt security from a customer and "reduced the proceeds paid to the customer by a payment for its services" to disclose under "brokerage charges" that "the proceeds you received from the debt security you sold were reduced by a payment to our firm for its services." Where the firm sold a debt security to a customer and "incorporated a payment to the [firm] in the price paid by the customer," the firm must state under "brokerage charges" that "a payment to our firm for its services was incorporated in the price you paid for the debt security you purchased."

This proposed disclosure is inaccurate and potentially misleading in several respects. First, the reference to "brokerage charges" implies an agency relationship when in fact the firm is acting as principal. Second, in principal transactions a firm does not actually "reduce the proceeds paid to the customer by a payment for its services" – a phrase that suggests the dealer executed a sale in the market on behalf of the customer and kept some of the proceeds. Instead, a firm establishes a price that is fair and reasonable in light of the current market and that in general (but not in all cases) affords the firm a profit that must be reasonable under the circumstances. The full proceeds of this sale price are paid to the customer. The proposed disclosure language may in fact confuse customers who have agreed to a certain sale price and who receive all the proceeds of that sale price, because it incorrectly suggests that their proceeds have been subsequently reduced below that price by a service charge to which they did not agree.[27]

In addition, the required form of the proposed disclosure requirement is unduly prescriptive. Rule 10b-10 generally does not require firms to use specific fields with specific labels, or set forth the precise language that must be used in connection with different types of transactions. Such specific requirements may impose difficult systems or operational issues for firms, particularly those that do not have excess field capacity on the "front" of their confirmations.

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[26] Indeed, although the Panel proposed additional confirmation disclosures for commissions, it noted, "[w]ith agent transactions . . . the payment/compensation to the broker-dealer was self-evident with the dollar amount disclosed on the trade confirmation as 'commission.'" Report at 8. This commission information is also already required under NASD Rule 2230.

[27] Although the required disclosure in connection with sales to customers does not reference a non-existent alteration in the agreed price, it also suggests an agency relationship in which services are provided rather than a principal transaction in which the firm receives a reasonable profit.

We recommend that the compensation disclosure requirement be revised to more accurately describe the possible existence of a mark-up or mark-down and to provide firms greater flexibility to determine how to present this information to customers. Most importantly, the systems and operational burdens of imposing this requirement should be reduced by permitting firms to provide the relevant disclosure in a generic form rather than specifying different disclosures that must be provided for different transactions. In our view, an appropriate generic disclosure (which may be printed on the back of a confirmation) would accomplish the objective of educating customers as to the possible existence of firm compensation or profit in connection with principal transactions.

We believe that this disclosure could take a variety of specific forms and that Rule 2231 should allow firms the flexibility to choose the approach most appropriate for their circumstances.[28] The Association would be pleased to discuss alternative forms of such disclosure further with the NASD.

F. Disclosure of Credit Ratings.

When a firm purchases or sells a debt security that is rated by any nationally recognized statistical rating organization ("NRSRO") to which the firm "subscribes," proposed Rule 2231 would require the firm to disclose the NRSRO and the credit rating.

Compliance with this requirement may raise several difficult issues for firms even aside from the obvious implementation concerns from a systems perspective. First, the circumstances in which the requirement applies are unclear. Proposed Rule 2231 does not define the term "subscribes," although this could include a variety of different types of "access" to ratings information. For instance, a firm's employees may have access to an NRSRO's ratings (either through a license agreement or otherwise), but in principle at least such access may not permit the firm to download the information into its confirmation generation and delivery systems and disseminate such information to its customers (or may permit such downloads or dissemination only for an additional cost) – does such a firm have a "subscription" to the NRSRO for purposes of the credit ratings disclosure requirement? A general reference to a firm's "subscription" to an NRSRO may not provide a meaningful or appropriate trigger for determining when Rule 2231 applies.

In addition, a requirement to disclose certain rating information may raise legitimate concerns for firms about the required content and scope of their disclosures. For example, a firm may subscribe to (and be able to include on its confirmation) rating information only from NRSRO A. What if that firm is also aware, however, that NRSROs B and C provide a lower rating for the security – but the firm cannot include that

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[28] By way of example, the disclosure could state in effect that if the firm acted as principal in the purchase or sale of a security, it may have priced the security at a level that would allow it to make a profit. As noted above, alternative approaches should also be acceptable.

information on its confirmation because it lacks the requisite systems, subscription or license? What if the firm is aware that the rating is on "watch" but does not have the systems, subscription or license to disclose this to customers? By providing some rating information, could firms be viewed as endorsing the view expressed by the NRSRO or obligated to provide other information necessary to put the rating into context or to update it in the future? When rating changes occur between the time the transaction is effected and the generation of the confirmation, which ratings should firms use? Firms may have significant operational difficulty in creating systems that generate confirmations on the basis of any information other than that provided in daily vendor feeds.

We are also concerned that proposed Rule 2231 may have unintended consequences for the commercial relationships between dealers and NRSROs. For example, if the effect of the Rule is to require firms to have the ability to disclose on confirmations the ratings of any NRSRO to which they subscribe, firms that might otherwise desire to have access to an NRSRO's ratings and/or underlying reports may choose to forgo such access if the costs of providing that NRSRO's rating information on customer confirmations are too burdensome.[29] These implications may be particularly troubling for smaller, retail-oriented firms.[30]

1. Allow Firms to Refer Investors to a Website Where Ratings Information Is Freely Available. The most straightforward approach to these issues would be to allow firms to refer investors to a readily-available source of ratings information, such as a website that would provide free access to ratings.[31] We strongly believe that referring investors to publicly-available sources of ratings information would better accommodate Rule 2231's disclosure objectives without imposing the potentially substantial burdens and uncertainty that compliance with the proposed Rule would entail. A website with publicly-available ratings information could also be used to enhance the information available to investors – for example, by providing them with the ability to

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[29] Depending on the meaning given to the word "subscribes," the Rule may also provide NRSROs undue leverage in negotiations over license fees in certain circumstances. For example, the Notice suggests that the NASD might consider mandating at least one subscription to an NRSRO.

[30] The SEC staff effectively recognized the costs, especially for smaller firms, of obtaining ratings from multiple NRSROs when it granted no-action relief that permitted broker-dealers to satisfy the current ratings requirement of Rule 10b-10 (*i.e.,* the requirement to disclose if a security is not rated at all) by following certain procedures that do not necessitate subscribing to all NRSROs. *Public Securities Association* (Sept. 29, 1995).

[31] The SEC recently noted that each current NRSRO publishes its credit ratings on a widespread basis at no cost, and has proposed making this a requirement to qualify as an NRSRO. *See* Release 33-8570 (Apr. 19, 2005) at 24. In addition, as the NASD recognized in its comment on the SEC's proposed point of sale disclosure requirements and confirmation requirements for mutual funds, most investors today have ready access to the internet. Letter from Robert R. Glauber, Chairman and CEO, NASD to Jonathan G. Katz, Secretary, SEC (Mar. 31, 2005) ("NASD Point of Sale Comment Letter") at 4.

compare the ratings of different debt securities, to review ratings history, to track the ratings of their bonds over time, to learn more about the meanings of different ratings, etc.[32]

2. *Consider an Incremental Approach to Credit Ratings Disclosure.* If the NASD determines that confirmations must include more rating information than is currently required, another approach would be to build incrementally on the existing provisions of Rule 10b-10 by requiring firms to disclose if a security is not rated "investment grade" by at least one rating agency.[33] Currently, for purposes of Rule 10b-10 firms must determine whether a debt security is rated (and must disclose if it is not). Rule 2231 could take this requirement a step further by requiring disclosure of the fact that the security is not rated investment grade by at least one NRSRO. Disclosure that a bond is not rated investment grade would provide individuals with notice that they are trading in a potentially riskier segment of the corporate debt market. At the same time, this requirement would build on existing broker-dealer systems that already must determine whether a bond is rated by an NRSRO but avoid some of the more difficult issues associated with passing through to investors specific rating information received from an NRSRO.

3. *Clarify the Rating Disclosure Requirement.* If notwithstanding our concerns and suggestions above the NASD determines to adopt the ratings disclosure requirement substantially as proposed, we recommend the following clarifications be made:

- *Clarify When a Firm "Subscribes" to an NRSRO.* The NASD should clarify that a firm "subscribes" to an NRSRO only when it has the right to disseminate the required rating information on customer confirmations and to provide any additional related information to customers necessary to clarify or explain such rating information.

- *Require Firms to Disclose Only One Rating.* If a firm subscribes to more than one NRSRO, Rule 2231 should require the firm to disclose

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[32] In another context, the NASD listed various advantages of internet disclosure, including facilitating comparison of investments, speedy delivery, and prompt updating. NASD Point of Sale Comment Letter at 4.

[33] Any such approach would have to provide clear guidance with respect to split ratings and should also describe how firms may satisfy the Rule without subscribing to all of the NRSROs. *Cf. Public Securities Association* (Sept. 29, 1995) (allowing firms to comply with the Rule 10b-10 requirement to disclose if a debt security is unrated without subscribing to all rating agencies).

only one credit rating. Such a requirement would achieve the Panel's recommendation that firms disclose the rating from "a" NRSRO.[34]

- *Apply the Ratings Disclosure Requirement Only to Customer Purchases.* Once a customer sells a debt security, it no longer has any reason to be concerned about performance (or lack thereof) of an issuer's obligations. Accordingly, it would seem unnecessary to provide credit rating information to a customer who sells, rather than buys, a debt security.

G. Indicators of Marketability and Liquidity.

Proposed Rule 2231 would require firms to disclose "whether transaction price information on the debt security is publicly available and if it is, that a customer may, if the debt security is a TRACE-eligible security, obtain such information at the Internet Web site www.nasdbondinfo.com for the customer's noncommercial use at no charge, or at other sources that provide such information."

1. Limit the Proposed Requirement to TRACE-eligible Securities. Although as discussed in Part II.B.1 above we propose that Rule 2231 as a whole should be limited to TRACE-eligible securities, it is particularly important that the price information requirement of the Rule be so limited.

If Rule 2231 requires disclosure of the existence of price reporting systems other than TRACE, a number of difficult questions need to be resolved to determine which systems provide appropriate "transaction price information" that is "publicly available." For example, what if price information is available only upon payment of an access fee or execution of an access agreement – is this information "publicly available"? What if the access agreement has provisions that restrict the use of information? What if the transaction data only picks up certain types of transactions (*e.g.*, trades on a particular trading platform, trades where both sides are NASD members, etc.) – does this qualify as "transaction price information"? Some process would need to be established to determine what pricing information for securities that are not TRACE-eligible needs to be disclosed under Rule 2231.

2. Clarify that Firms Can Refer Customers to Any Publicly Available Source of Transaction Price Information. Although the text of the Rule is somewhat ambiguous in this respect, it would appear to require firms to refer their customers in every case to www.nasdbondinfo.com as a source of transaction price information. Firms should be permitted to refer their customers to any website that makes transaction price information for the relevant security available at no charge (or which links customers to

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[34] Report at 14.

such information). In addition to *www.nasdbondinfo.com*, transaction price information (and other useful educational materials) are available at *www.investinginbonds.com*. Firms may also have their own websites that make transaction price information available to their customers at no charge or that provide clear links to *www.nasdbondinfo.com*, *www.investinginbonds.com* or another source of free transaction price information. Especially since the Panel's Report did not mandate or recommend the use of any particular source of transaction price information, a firm should have the flexibility to refer customers to any pricing source that provides the relevant information.

H. The Frequency of Interest and Principal Payments.

In connection with transactions in which customers purchase debt securities,[35] proposed Rule 2231 would require firms to disclose the frequency of interest and principal payments.

1. Permit Firms to Provide this Information Upon Request. For certain debt securities, the frequency of interest or principal payments cannot be stated in a straightforward manner because they do not pay interest or principal on a regular schedule (*e.g.*, certain structured notes that pay interest or principal only if and to the extent payments are made on a reference asset). In such cases, providing a description of the frequency of interest and principal payments can become quite complicated. In addition, developing systems to track the interest and principal payment dates for different types of bonds and feed it into the confirmation generation systems presents substantial technical and operational challenges.

We recommend that dealers be required to provide this information upon customer request rather than for each trade. As in the case of information regarding variable rate interest – which Rule 2231 would permit to be disclosed upon customer request – the costs to firms of describing the frequency at which bonds pay interest and principal on a case by case basis is not justified by the benefits this information will provide to investors, especially if investors are notified that this information is readily available to them.[36]

2. Clarify the Required Disclosure of the Frequency of Interest and Principal Payments. The NASD should confirm that this requirement can be satisfied in any way that conveys the frequency of the payments – for example, by stating the payment

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[35] The lead-in to section (b)(5) of the Rule should clarify that, by "purchases," it refers to *customer* purchases (rather than firm purchases). A similar approach should be taken for any other provisions of the final Rule that apply to customer purchases only.

[36] If the NASD does not permit disclosure upon request, at a minimum it should exclude from the scope of this requirement bonds whose interest and principal payments do not occur in accordance with a standard schedule that can be easily summarized for customers.

months (*e.g.*, Jan., July) – as well as by stating the frequency (*e.g.*, monthly, quarterly, semi-annually, annually, at maturity).[37] Since principal payments on most corporate bonds are paid only at maturity, the Association also recommends easing the implementation burden associated with this requirement by limiting the obligation to disclose the frequency of principal payments to debt securities that have regularly scheduled principal payments prior to maturity.

I. Yield to Maturity.

In connection with transactions in which customers purchase debt securities, proposed Rule 2231 would require firms to disclose the yield to maturity.

1. The Proposed Yield to Maturity Disclosure Requirement Should Be Eliminated. Subject to certain limited exceptions for situations in which "it is not possible to calculate a meaningful yield to maturity,"[38] Rule 10b-10 already requires the disclosure of yield to maturity, unless the debt security is sold on the basis of a yield that is lower than the yield to maturity. Thus, in most cases this requirement of proposed Rule 2231 is duplicative and unnecessary. In those cases in which yield to maturity is calculable but *not* currently required to be disclosed under Rule 10b-10, confirmations must still disclose the lower yield on which the debt securities were sold (*e.g.*, yield to call or yield to put). A requirement under Rule 2231 to also disclose yield to maturity in these instances would not enhance the disclosure provided to the customer – since it would only result in disclosure of a *higher* yield than that used by the parties to effect the trade. Accordingly, the Association suggests eliminating the additional requirement to disclose yield to maturity.

2. If a Yield to Maturity Disclosure Is Adopted, Some Debt Securities Should Be Exempted from the Requirement. If the NASD determines to include yield to maturity in Rule 2231, it should also include a general exemption for debt securities for which yield to maturity cannot reasonably be determined. Such debt securities include, but are not limited to, those with a variable interest rate, with a maturity date extendible by the issuer,[39] with interest deferrable by the issuer, with no maturity date ("perpetual" securities), which pay a variable amount of principal at maturity, which are mandatorily

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[37] We note that even under this approach clarification from the NASD may be necessary as to how to describe the payment features of certain types of debt securities.

[38] Release 34-19687, 48 Fed. Reg. 17583, 17584 (Apr. 25, 1983) (creating exceptions for, among other things, securities with a variable interest rate or with a maturity date extendible by the issuer).

[39] The first two of these categories are expressly exempted from the yield to maturity disclosure requirements of Rule 10b-10 because "it is not possible to calculate a meaningful yield to maturity" for such securities. Release 34-19687, 48 Fed. Reg. 17583 (Apr. 25, 1983).

convertible or exchangeable or convertible or exchangeable at the option of the issuer, or which have defaulted.[40]

J. Callable Securities.

In connection with transactions in which customers purchase callable debt securities, proposed Rule 2231 would require firms to disclose "whether the debt security is continuously callable or otherwise callable, and the next occurring call date and associated call price."

1. Eliminate the Requirement to Disclose Information about the Next Occurring Call Date. A requirement to disclose the next occurring call date and the associated call price raises difficult compliance issues for firms trading certain securities. In particular, for securities with complex early redemption provisions it frequently will not be clear which date and price should be disclosed. It may be possible to reduce this uncertainty by narrowly defining the "next occurring call date" – for instance, by designating the "next occurring call date" as the first call date for which a call notice could be delivered after the trade date (rather than a call date that occurs after the trade date but for which a notice would have to have been delivered earlier) and on which the issuer could, without restriction, call the entire issue (rather than a portion of the issue).[41] But even this approach would necessarily ignore the complexity of certain early redemption features and potentially confuse customers in certain situations (*e.g.*, where there is an earlier partial or restricted call). The SEC has consistently recognized these difficulties in identifying the first call date for a bond and has instead required only disclosure that the bond may be redeemable (together with an offer to provide additional information on request).[42]

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[40] In other contexts, the NASD has recognized the existence of debt securities for which reporting yield would provide inaccurate or misleading information. NASD Rule 6230(c)(13) provides that firms are not required to report yield to TRACE:

> when the TRACE-eligible security is a security that is in default; a security for which the interest rate is floating; a security for which the interest rate will be or may be increased (*e.g.*, certain "step-up bonds") or decreased (*e.g.*, certain "step-down bonds") and the amount of increase or decrease is an unknown variable; a pay-in-kind security ("PIK"); any other security where the principal or interest to be paid is an unknown variable or is an amount that is not currently ascertainable, or any other security that the Association designates if the Association determines that reporting yield would provide inaccurate or misleading information concerning the price of, or trading in, the security.

[41] This approach is similar to that taken under Municipal Securities Rulemaking Board Rule G-15.

[42] In 1982, the SEC considered suggestions that yield to call information be included on confirmations of debt securities but determined that doing so "frequently would be difficult, . . . because of the widespread and increasing use of complex early redemption provisions, such as part issue calls and sinking funds, that can make difficult the selection of an appropriate call date upon which to base the calculation." Release 34-

(continued. . .)

2. If Call Information is Required, Clarify the Disclosure Requirement and Exempt Some Debt Securities. If the NASD nonetheless chooses to adopt more specific call date and price disclosure requirements, the manner in which firms may fulfill this obligation should be made clear. In addition to specifying how a "next occurring call date" is determined, Rule 2231 should (i) explain when a security is "continuously callable" (*e.g.*, specify whether a security that can be called at any time from five to ten years after issuance is "continuously callable" at issuance), (ii) explain the disclosure required when a debt security is "otherwise callable" and (iii) exempt from the relevant requirement debt securities where the next call date or call price cannot reasonably be determined (*e.g.*, where the call price is variable).

K. Variable Coupon Rate Securities.

If a customer purchases debt securities carrying a variable coupon rate, proposed Rule 2231 would require firms to send a disclosure "indicating that the coupon rate may vary and that the [firm] will provide in writing additional information relating to the calculation of the debt security's interest and principal payments upon a written request from the customer that is sent not later than six months from the date of settlement." Proposed Rule 2231 specifies certain information that would be required in a response to such a request, and specifies that the response must be sent within three business days of receipt of the request.[43]

(. . . continued)

18988 (Aug. 20, 1982), 47 Fed. Reg. 37920, 37922 (Aug. 27, 1982). Instead, the SEC required firms to include a general legend on confirmations for securities that are subject to redemption before maturity "to the effect that the debt security may be redeemed in whole or in part before maturity, that such a redemption could affect the yield represented and the fact that additional information is available upon request." Rule 10b-10(a)(4).

As recently as last year, the SEC revisited the issue of disclosure of call information. *See* Release 34-49148, 69 Fed. Reg. 6438, 6464 (Feb. 10, 2004). In particular, the SEC proposed amendments to Rule 10b-10 to deal with the situation in which the confirmation must include yield-to call information (because the transaction was effected on the basis of yield to call) and the relevant call date used for calculating such yield, but that call date is *not* the *next* call date. The SEC was concerned that disclosing a call date that is not the next call date might "confuse investors who are not otherwise aware that a bond may be called on a date earlier than the one specified on the confirmation." The SEC proposed requiring disclosure of the next call date in these limited circumstances, but did *not* propose that call information be provided more generally. Indeed, the SEC reaffirmed the difficulties associated with providing more detailed call disclosure and noted it had previously concluded that "in light of the variety and number of call provisions. . . 'a legend advising the customer that he may request information from his broker-dealer is a sensible approach to this problem.'" *Id.* (quoting Release 34-18988).

[43] The Rule would require disclosure of the amount of the next interest payment, a statement that this amount will change if the coupon rate changes, an explanation of how often the coupon rate may be

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1. Modify the Disclosure Requirements to Accommodate the Complexity of Variable Rate Securities. Rule 2231 should not identify in detail the types of additional information that must be provided in response to a customer's request. The multiplicity and complexity of variable coupon rate provisions make it inappropriate to delineate this additional information with such specificity – especially since some of the information listed in proposed Rule 2231 will not always be reasonably determinable and other information may be more appropriate to provide the customer in certain cases.[44] In addition, a more flexible approach would be consistent with Rule 10b-10 – which requires firms in certain instances to offer additional information upon request, but does not specify the detailed content of the response.

2. Harmonize the Response Time with Rule 10b-10. The three business day response time provided in Rule 2231 may be too short for some unusual and uncommon debt securities, especially since customers have up to six months to make the request and some information may need to be generated at the time of the request. In our view, a more appropriate timeframe would be that specified in Rule 10b-10(c), pursuant to which broker-dealers are permitted five business days to respond to requests for additional information (or fifteen business days if the request is received more than thirty days after the date of the relevant transaction).

3. Clarify the Proposed Disclosure with Respect to Variable Coupon Rate Securities. Any requirement to disclose on a trade-by-trade basis that a bond carries a "variable coupon rate" should afford firms maximum flexibility in terms of how this information is presented. In particular, firms should be able to satisfy the requirement with a variety of indicators (*e.g.,* stating "variable," "var," "floater" or "VRN" in the description of the debt security or in place of a rate). Firms should also be permitted to provide the disclosure regarding the availability of additional information in the form of a generic statement printed on the back of the confirmation.

L. Callable Zero Coupon Bonds.

If a customer purchases debt securities that are callable and, at issue, are not structured to include scheduled interest payments (*e.g.,* zero coupon bonds), proposed Rule

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recalculated, an explanation of the event(s) that may trigger the recalculation, and the formula for recalculating such coupon rate.

[44] For instance, the applicable rate may not always be known at the beginning of the interest payment period (*e.g.,* a note that bears interest based on a compounded overnight rate or various structured notes), in which case the amount of the next interest payment may not be reasonably determinable. Similarly, not all variable rate securities will have a straightforward formula for recalculating a coupon rate (*e.g.,* a structured note with payment characteristics similar to an asset-backed security).

2231 would require firms to disclose "the compound accreted value as of the next occurring call date." In addition, firms must disclose "whether the call price equals, exceeds, or is less than the compound accreted value as of the call date."

1. Exclude Certain Securities from this Requirement. In addition to the difficulties noted in Part II.J.1 above with respect to the identification of the "next occurring call date," the compound accreted value will not be reasonably determinable for some types of zero coupon debt securities, including (but not limited to) those that accrue interest at a variable rate, which pay a variable amount of principal at maturity, which are mandatorily convertible or exchangeable or convertible or exchangeable at the option of the issuer, or which have defaulted. Such debt securities should be excluded from this requirement.

2. A Comparison Between Compound Accreted Value and Call Price Should Not Be Required. If (notwithstanding our comments above) Rule 2231 ultimately requires disclosure of the next occurring call date and the associated call price, the confirmation will already include the information necessary for a customer to compare the compound accreted value with the next call price, and therefore there is no need to state whether the "call price equals, exceeds or is less than the compound accreted value."

It is not clear, moreover, why a comparison of call price to compound accreted value would be necessary if the call price is higher (rather than lower) than the accreted value – since the apparent purpose of this comparison is to warn investors of the possibility that their bond may be called for less than the compounded accreted value. If that is the purpose of this comparison, it could be achieved by providing generic disclosure to the effect that for zero coupon bonds, investors should be aware that if the call price as of any call date is less than the compound accreted value as of that date, the bond may be called on that date for less than the compound accreted value. If necessary, firms could also be required to provide additional information upon customer request – which would provide them with the flexibility to respond to such inquiries in a manner consistent with the particular features of the bond.

III. Comments on the NASD's Brochure.

Proposed Rule 2231 would require that disclosures under the Rule include (in a "clear and conspicuous manner") a specified statement regarding the availability from the NASD's website (or, upon written request, from the firm) of the NASD-prepared Brochure.

A. Use of *www.investinginbonds.com* for Educational Materials.

The Association strongly believes that *www.investinginbonds.com*, rather than the NASD's website and its Brochure, provides the best tool for offering investors additional educational information on corporate bonds. The industry, with input from regulators and investors, has spent considerable time, effort and resources developing this

unique website into the most comprehensive source of investor information for fixed income securities – including U.S. Government securities, municipal bonds, corporate debt and mortgage- and asset-backed securities. The content of the site, which includes a wide variety of market data, news, commentary and information about bonds that is continually enhanced and updated, is geared towards a wide range of investors – from beginners to experienced equity investors who are new to bonds to sophisticated bond investors. The site is non-commercial in orientation and can be accessed free of charge.

We note, moreover, that this site provides investors with much more extensive information than the proposed Brochure. In addition to offering general information under such headings as "Bond Basics," "What You Should Know," "Buying and Selling Bonds," "Types of Bonds," etc., the site has an "About Corporate Bonds" area that offers an extensive discussion of corporate debt under the following headings: "Corporate Bonds," "High Yield Bonds," "Fixed Rate Capital Securities," "Corporate Bankruptcy and Your Investment," "Rating Changes and Your Investment," and "Certificates of Deposit." Each of these headings has numerous sub-topics.[45] The website also offers more detailed descriptions of the different types of bonds and the various characteristics they may have.

Given the existence and features of *www.investinginbonds.com* and its current extensive use as a tool to promote investor education, we do not believe there is any compelling rationale for the NASD to develop and mandate the use of its own website and Brochure in order to achieve the same objectives. We therefore respectfully request that if the NASD determines to adopt Rule 2231 substantially as proposed in this respect, it articulate why reference to its website and use of its Brochure is a necessary substitute for *www.investinginbonds.com*. We note that to the extent the NASD seeks to have a standardized document that can be delivered to investors in "hardcopy" form as well as through a website, we would be pleased to work with the NASD to identify appropriate materials from the "About Corporate Bonds" section of the website (and, if necessary, to reformat these materials) so that they can be delivered in hardcopy to investors who so request.

B. Comments on the Specific Notice Requirement in Rule 2231.

1. The Required Statement Regarding Educational Materials Should be Permitted on the Back of the Confirmation and in a Shorter Form. The statement that proposed Rule 2231 requires firms to provide in a "clear and conspicuous manner" is so

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[45] For example, sub-topics under "Corporate Bonds" include "What are Corporate Bonds?", "How Big is the Market and Who Buys?", "Benefits of Investing in Corporate Bonds," "Types of Issuers," "Basic Terms of Bonds," "Understanding Interest-Rate Risk," "Understanding Yields," "Understanding 'Call' and Refunding Risk," "Understanding Collateralization," "Understanding Credit Risk," "Bond Funds," "How Corporate Bonds are Taxed," "Other Basic Facts," and "Glossary."

long that space and systems considerations may make it very difficult for firms to include it with the transaction-specific terms on the "front" of the confirmation.[46] The NASD should delete the "clear and conspicuous" requirement and clarify that generic disclosure on the "back" of a confirmation would satisfy this requirement. Since space on the "back" of the confirmation is not unlimited, firms also should be permitted to shorten the reference to the educational materials as much as possible – *e.g.*, "Information about bonds, bondholders' rights and the risks of bond investments is available at www.investinginbonds.com or from your broker upon written request."

2. *Consider Alternative Means of Notifying Customers of Educational Materials.* We urge the NASD to consider permitting firms to notify investors of the existence of additional educational materials other than in connection with each transaction. The available space on the "back" of confirmations is not unlimited, and in our view there are a variety of appropriate ways to notify customers about such educational materials. For example, firms should have the flexibility to satisfy the Rule 2231 requirement by referring to www.investinginbonds.com in a periodic account statement (rather than a trade confirmation) or by providing relevant materials from that site to a customer in electronic or paper form (*e.g.*, when opening an account).

C. Comments on the Proposed Brochure.

Because the Association does not believe that the Brochure should be used to provide additional educational information to retail investors, we have not made comprehensive comments on it in this letter. If the NASD nevertheless determines to use the Brochure, we would appreciate the opportunity to offer more detailed suggestions and comments to the NASD. We have, by way of example, summarized below some of the modifications to the Brochure that we believe would be necessary.

1. *Provide a More Balanced Perspective on the Risks of Investing in Corporate Bonds vs. Other Investments.* Corporate bonds – particularly bonds in the investment grade category in which we understand individuals usually invest – are not inherently more speculative than equity securities, and yet no disclosure requirement

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[46] The required statement is as follows:

> "A disclosure document discussing your rights as a bondholder and some of the risks related to buying and holding bonds, titled "Important Information You Need to Know About Investing in Corporate Bonds," has been prepared by NASD and is available online at www.NASD.com. A paper version of this document is available from your broker upon your written request made not later than six months from the date of settlement of your transaction."

An additional concern about this disclosure is that the use of such a lengthy legend regarding transactions in debt securities, combined with the absence of similar disclosure about equities, may suggest to customers that debt securities are more risky than equities.

comparable to the proposed Brochure is imposed for equity securities. Investor education materials should present a balanced perspective on the relative risks and rewards of different investments available to retail investors – and not create the impression that corporate debt is somehow more risky than equity. The Brochure should include a description in general terms of the role that corporate debt can play in effective portfolio management.

2. *Review Discussion of Commissions and Yield Calculations.* Pursuant to guidance from the NASD and the SEC,[47] broker-dealers are required to factor into the yields disclosed on confirmations the commissions and other remuneration received from customers (other than incidental transaction fees and other miscellaneous charges that are small and do not vary with the size of the transaction). The proposed disclosure suggests that it may be common practice to not include a firm's remuneration (mark-up, mark-down or commission) in the yield. We do not understand the basis for this presumption. Most debt transactions are effected on a principal basis, and the "mark-up" or "mark-down" would be factored into the price and the resulting yield to the customer. In the case of agency transactions, it is not clear that commission is typically excluded from yield. We believe the rationale for this disclosure needs to be clarified, and would welcome the opportunity to discuss this issue further with the NASD.[48]

3. *The Interest Rate Risk Discussion Should Be Refined.* The discussion of the effects of changing interest rates on bond prices should be expressly limited to fixed rate bonds. The statement that "interest rate risk increases the longer you hold a bond" should instead refer to the remaining term of the bond until maturity. In addition, the reduction in prices of older, lower coupon fixed rate bonds when newer higher coupon fixed rate bonds are issued is probably better explained as the result of yield equalization than a "depressed appetite for older bonds."

4. *Avoid Creating the Impression That There Is a Sharp Break Between Investment Grade and Non-Investment Grade Bonds.* Some statements under

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[47] *See* The Bond Market Association (Aug. 24, 1998); NASD Regulatory & Compliance ALERT (Sept. 1997).

[48] We believe the discussion of yield also needs to be clarified in certain respects. For example, the second paragraph under "yield" makes references to "current yield." Although it is accurate to state that the current yield is 8% (when a bond is sold at par, its current yield and yield to maturity both equal its coupon rate), "current yield" is not defined in the Brochure. More significantly, current yield generally should not be the focus of the investor's decision.

Incidentally, when the Brochure states in this paragraph that the sale price of the bond is $1,000, it presumes that the bond has a $1,000 face amount. While a $1,000 face amount is a common convention in the industry, the individual investors who are the intended audience of the Brochure may not be aware of this. It would be better to state the bond "sells today for its face amount of $1,000."

"Defaults and Credit Risk" may create the impression that there is a substantial difference in credit risk between the lowest investment grade rating and the highest non-investment grade rating.[49]

5. *The List of Special Features is Far from Complete.* The Brochure should make it clear that the list of special features is not a complete list of special features of bonds. While it might be useful to add a discussion of additional bonds with special features (*e.g.*, puttable bonds, amortizing bonds and structured notes) it is important at least to inform customers that they should always be aware of the possible existence of other special features.

6. *The Discussion Under "No Commission Does Not Mean No Charge" Should Be Revised.* This discussion generally should be revised in a manner consistent with our comments in Part I.D above. For example, the element of dealer profit that is priced into a principal transaction generally is not properly characterized as "similar to a commission." Furthermore, the proper reference for determining the amount of dealer mark-up or mark-down is not the price that the dealer paid for the bond (except in the narrow case of a riskless principal transaction) but rather the prevailing market price.

7. *The Discussion Under "Would a Similar Bond Cost Less?" Should Be Reviewed.* It is helpful to remind investors to always consider whether lower-priced alternative investments with similar risk/return profiles are available. However, by connecting this advice to broker conflicts of interest and broker compensation, the Brochure risks obscuring this point. In addition, the disclosure should not suggest that the existence of broker compensation necessarily results in a higher price for a comparable security, or that such a higher price necessarily reflects higher broker compensation.

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[49] *See* http://www.investinginbonds.com/learnmore.asp?catid=46&id=8 for a discussion that makes it clearer that credit risk is a continuous spectrum.

The Association appreciates this opportunity to address the issues raised by Notice 05-21. If you have any questions concerning these comments, or would like to discuss our comments further, please feel free to contact me at 646.637.9220 or via email at mdavid@bondmarkets.com.

Sincerely,

/s/ Michele David

Michele C. David
Vice President and
Assistant General Counsel

cc: *NASD*
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
James L. Eastman, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight
Sharon K. Zackula, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight
Douglas Shulman, President, Markets, Services, and Information
Stephen I. Luparello, Executive Vice President, Market Regulation and U.S. Exchange Solutions
Elliot Levine, Chief Counsel, Transparency Services, Markets, Services and Information
Malcolm Northam, Director of Fixed Income Securities Examinations and Staff Liaison to the NASD Fixed Income Committee

U.S. Securities and Exchange Commission, Division of Market Regulation
The Hon. Paul S. Atkins, Commissioner
Annette L. Nazareth, Director
Robert L. D. Colby, Deputy Director
Catherine McGuire, Chief Counsel

NASD Fixed Income Committee
Joseph A. Sullivan, Chairman

NASD Corporate Debt Market Panel
John J. Brennan, Chairman

The Bond Market Association
Micah Green, President
Marjorie Gross, Senior Vice President and Regulatory Counsel