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Office of the Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, DC 20006-1506

Subject: Comments on Regulatory Notice 12-39 (TRACE Dissemination Issues)

Ladies and Gentlemen,

On behalf of our clients—value-oriented broker-dealers, investment advisers and investors—The Nelson Law Firm, LLC respectfully submits these comments on the proposal of the Financial Industry Regulatory Authority, Inc. (“FINRA”) to eliminate or modify the dissemination caps on TRACE volume information, as described in the above-referenced Regulatory Notice (the “Proposal”). We have, on several other occasions, made public comment on this issue,¹ and we are grateful to have to opportunity to comment on this issue again.

We strongly support FINRA’s proposal to eliminate the dissemination caps. We believe that all dissemination caps, regardless of type of security, should be eliminated, because any limitation on the dissemination of trade information is an impediment to a competitive, free and open market. We would support an increase in the level of the dissemination caps, as we believe that any increase in the quantity and quality of transaction information that is disseminated would be a step in the right direction. However, unless FINRA eliminates all dissemination caps, this effort will fall short of creating the complete transparency that is essential to efficient competition among broker-dealers and the proper functioning of our

¹ See Comments of The Nelson Law Firm (i) dated March 31, 2009, relating to File No. SR-FINRA-2009-004, (ii) dated May 5, 2009 relating to File No. SR-FINRA-2009-010, (iii) dated November 13, 2009 relating to SEC Release No. 34-60726, File No. SR-FINRA-2009-010, and (iv) dated November 13, 2009 relating to File No. SR-FINRA-2009-010.

securities markets. We do not believe that there is any valid reason for withholding volume information from public dissemination on trades of any size.

We also strongly support FINRA's proposal to disseminate Rule 144A transaction data. We believe that the dissemination of Rule 144A transaction trade data would be a desired enhancement to TRACE. There are many instances when registered bonds trade alongside Rule 144A bonds and full real-time dissemination of trade data for each of these types of securities is essential to price discovery and would provide market participants the tools to make more informed and better investment decisions.

Elimination of Dissemination Caps is the Next Logical Development for Bond Markets

FINRA and the Securities and Exchange Commission ("SEC") have long acknowledged the benefits to the investing public from the dissemination of real-time trade and volume data during market hours. For example, in 1992, in its comments to the proposed penny stock rules, FINRA's predecessor (NASD) stated that the "dissemination of real-time trade and volume data during market hours will significantly benefit investors by providing the same high degree of market visibility and more efficient price discovery . . ."² In 1997, in the context of trading foreign equity securities, the SEC stressed the value of real-time dissemination of market data when it noted that dissemination of trade reports has the potential "to better enable investors to monitor the executions they receive in foreign securities."³

TRACE was introduced in 2002 in order to "increase price transparency in the U.S. corporate debt market." Since that time, FINRA and the SEC have made several enhancements to the system in order to promote market transparency and competition, including the following:

- The TRACE dissemination protocols were expanded to publicly disseminate the buy/sell and dealer/customer data elements. This improvement enhanced "market transparency by allowing TRACE users to better understand what a reported price actually represents." (SEC Release 34-58115, Jul. 7, 2008)
- The scope of securities subject to reporting and dissemination through TRACE was expanded to include non-registered and Rule 144A transactions. (SEC Release 34-59768, Apr. 14, 2009)
- TRACE was expanded to include agency debt securities and primary market transactions, because "[t]he expansion of TRACE will create consolidated post-trade transparency in Agency Debt Securities, and the dissemination of transaction information will assist in price discovery and valuation processes for all market

² SEC Release No. 34-30608 (Apr. 20, 1992).

³ SEC Release No. 34-38456 (Mar. 31, 1997).

participants and provide retail investors access to price information current not readily available to non-professionals.” (SEC Release 34-60726, Sept. 28, 2009)

- Asset-backed, mortgage-backed and similar securities were made subject to TRACE reporting (SEC Release 34-61566, Feb. 22, 2010) and dissemination (but still subject to dissemination caps) (SEC Release No. 34-66829, SR-2012-020, Apr. 18, 2012; see *also* proposal to disseminate additional information, SEC Release 34-67798, SR-2012-042, Sept. 7, 2012).

FINRA’s protocol of capping dissemination of volume information (which was never instituted through the formal rulemaking process) runs contrary to the general trend in rulemaking to enhance transparency in debt and equity reporting and dissemination. The elimination of the dissemination cap protocol would be a logical and essential next step.

Dissemination Caps Inhibit a Free and Open Market in Debt Securities

Section 15A(b)(6) of the Securities Exchange Act of 1934 requires, among other things, that FINRA rules must be designed to “remove impediments to and perfect the mechanism of a free and open market.” Competition is an essential component of a free and open market in securities. In turn, the wide dissemination of information about securities prices and transactions costs is necessary for the creation and maintenance of free, open and competitive markets.

The SEC and FINRA have long followed this guiding principle in designing a system of regulation to ensure that securities markets are transparent and competitive. Regulation should require accurate and complete information be made available to the public. This information places competitors on an equal footing, resulting in a free and open market, and thereby ensuring that resources are properly allocated to their most valued use.

Dissemination caps are an impediment to free and open markets. Without the benefit of complete information about trades, investors are unable to accurately gauge the quality of executions received from bond dealers and end up paying higher execution costs than competitive markets would allow.

FINRA’s rules have long required most TRACE-eligible securities to be disseminated pursuant to FINRA Rule 6750.⁴ Nonetheless, the TRACE system has, since 2002, followed

⁴ FINRA Rule 6750 on Dissemination of Transaction Information provides that “FINRA will disseminate information on all transactions in TRACE-eligible securities immediately upon receipt of the transaction report, except as provided below.” The only information that is currently not required to be disseminated is (i) information on a transaction effected pursuant to Rule 144A under the Securities Act, (ii) transfers of certain proprietary positions effected in connection with broker-dealer mergers or consolidations, (iii) List or Fixed Offering Price Transactions or Takedown Transactions, or (iv) information relating to transactions in Asset-Backed Securities.

an internal protocol⁵ of implementing dissemination caps. For investment grade TRACE-eligible debt transactions with a par value above \$5,000,000, the disseminated volume is capped at \$5,000,000, and for non-investment grade debt transactions with a par value greater than \$1,000,000, the disseminated volume is capped at \$1,000,000. Agency debt securities have a dissemination cap of \$5,000,000, agency pass-through mortgage-backed securities traded to be announced (“TBA transactions”) (for good delivery) are capped at \$25,000,000, and TBA transactions (not for good delivery) are capped at \$10,000,000.

The dissemination protocol is inconsistent with the terms of FINRA’s Rule 6750 and the regulatory goals of TRACE. For TRACE to perfect the mechanism of a free and open market in debt securities, protect investors and enhance competition, FINRA must abandon this protocol in its entirety and disseminate all trade data information for all reported trades to the public. Otherwise, TRACE data, and particularly TRACE data relating to non-investment grade debt transactions, will continue to be of limited utility to many investors and there will continue to be an unnecessarily flawed market in debt securities.

One particularly egregious flaw in the current dissemination cap protocol turns cap limits on their heads. Investment grade debt, which generally trades consistently at or around par, and for which there is little price difference regardless of volume levels, is capped by FINRA at \$5,000,000. However, non-investment grade debt, which frequently trades at deep discounts to par, and for which prices can vary significantly at different volume levels, is capped by FINRA at \$1,000,000. The protocol would make more sense if the size of these caps were reversed.

Nonetheless, the primary problem is that dissemination caps withhold vital information regarding trades from the investing public, which inhibits competition. Our clients manage large portfolios, frequently trade in debt, and often purchase non-investment grade bonds that trade at significant deep discounts to par. Real-time information relating to the exact number of bonds traded is vital to the interpretation of trade data and trade execution costs. Our clients have a duty to evaluate the quality of their executions, and they generally use TRACE reports to make a best execution determination. Orders will flow to bond dealers providing better executions at lower costs, as suggested by the TRACE data. Thus, it is essential for investment managers to have complete transparency in trade information in order to properly evaluate whether they have received best execution with respect to any debt transaction in which they are participants, and to determine whether orders should be directed to market participants that provide better executions at lower costs.

⁵ This protocol was never proposed or approved as a FINRA rule through the formal rulemaking process. The protocol was previously disclosed only in FINRA’s TRACE User Guides and mentioned in certain recent rule proposals (SEC Release No. 34-66829, SR-2012-020, Apr. 18, 2012, and SEC Release 34-67798, SR-2012-042, Sept. 7, 2012). Currently, the protocol does not appear to be disclosed in any publicly-available TRACE manuals.

For example, suppose that two institutional investors have each submitted an order to different broker-dealers to purchase 50,000 non-investment grade bonds. The first investor receives an execution for 2,000 non-investment grade bonds at ½ of par. The TRACE report submitted to FINRA would show a par value of \$2,000,000 and a purchase price of ½ of par. However, due to the dissemination caps, the public report would show the par value to be \$1,000,000+ with a purchase price of ½ of par. Now suppose that the second investor in a contemporaneous transaction receives an execution for 50,000 of the same bonds at ½ of par, thereby receiving a complete fill on its order. The TRACE report submitted to FINRA would show a par value of \$50,000,000 and a purchase price of ½ of par, but the public report would again show a par value of \$1,000,000+ with a purchase price of ½ of par. The public dissemination appears to show that each investor purchased the same number of bonds, since both transactions report the same par value, \$1,000,000+, but in fact the second investor received twenty-five times as many bonds.

Clearly, the investor in the second example, all other things being equal, received a much better execution than the first investor. The first investor is subject to market risk on the remainder of its order and the order may never be filled at a reasonable price. But, nothing in the TRACE report disseminated to the public would alert the first investor to the fact that the second investor's broker did a much better job of filling its order than her broker did. In a free and open market, the first investor would know this information and would be able to immediately complain of this execution failure to the firm that made the trade on her behalf. If that complaint failed to produce a satisfying result, the investor would likely shift her business to the other firm.

Eliminating the dissemination caps will enable sophisticated investors to compare, in real-time, the executions received by different broker-dealers. In the securities industry as well as other industries, consumers (investors) seek the best execution of their orders. Disclosure allows customers to understand how they are being treated, and if they are repeatedly allocated inferior executions, will take their business elsewhere. Competition forces suppliers to provide better service at lower prices. A higher-priced market participant providing inferior service that wishes to retain its business will be forced to improve service and lower its rates. Enhanced competition in the bond market will result in better executions for customers and a narrowing of the differences in execution rates and prices as investors seek the best executions available. By removing the dissemination caps, the bond market will become more competitive, execution prices will be driven to fair prices by customer choice, best execution obligations will be satisfied and capital will end up being allocated to its most efficient use.⁶

⁶ It is important to note that FINRA and the SEC are required to consider the effect on competition of every rule or rule change that it proposes. See the SEC's Current Guidance on Economic Analysis in SEC Rulemaking (Mar. 16, 2012) ("Rulemaking Guidance"). In the Rulemaking Guidance, the SEC reiterated that it is required "to consider the impact that any rule promulgated under [the Exchange] Act would have on competition and to include in the rule's statement of basis and purpose 'the reasons for the Commission's...determination that any burden on competition imposed by such rule or regulation is necessary or appropriate in furtherance of the purposes of [the Exchange Act.]'" See Rulemaking Guidance,

The Lack of Liquidity Argument in Favor of Dissemination Caps Is Not Valid

We believe that FINRA instituted this protocol of withholding volume information from the investing public not because of any systems limitations or technical reasons, but because FINRA-member firms participating in the debt market resisted the complete dissemination of trade information that was required under Rule 6750 in order to avoid competitive pressure. The affected broker-dealers claimed (and will likely continue to claim) that dissemination would impair debt market liquidity.

We do not believe the lack of liquidity argument is valid. Bond investors are the source of liquidity in the bond markets, not broker-dealers, who are the source of transactions costs. Broker-dealers arguing for dissemination caps essentially are saying that they cannot be profitable in a competitive market.

We reject the concept of roadblocks to competition in almost every sphere of life; why should we give it validity in the securities markets? Competition inspires innovation, as competitors seek to find lower cost methods to deliver services. We are all richer as a result. Roadblocks to competition discourage innovation and impoverish us. The proponents of dissemination caps confuse their own interests with the public interest and the inability to compete with a lack of liquidity.

It has been argued that the original intent of the dissemination caps was to protect a broker-dealer's capital commitment. This is simply another expression of the fear that some broker-dealers would not survive in a more competitive market. There is no valid reason to continue the practice of protecting bond dealers from competition. History informs us that efforts to protect some industry sub-group from competition are doomed to failure. While anti-competitive practices continue, the investing public is made to suffer. It is time to remove the dissemination caps and allow the cleansing power of the market to sweep away firms that are unable or unwilling to compete.

This is not the first time that investors have heard complaints from the industry that transparency would hurt liquidity. In the early 1990's, broker-dealers in equity markets resisted similar disclosures. But time has proven such claims to be false, even for thinly-traded securities. The dissemination of information about equity transactions resulted in astounding systems competition and extremely low transactions costs; yet markets, if anything, are more liquid than ever. Experience has taught us that transparency and competition benefit investors and improve markets. Regulatory roadblocks to competition hinder capital formation and the free flow of invested capital.

We do not believe there is any valid justification (statutory or otherwise) for the imposition of the TRACE dissemination caps. The SEC and FINRA exist to protect the investor and perfect the mechanism of free and open market, not broker-dealer profits. It is contrary to the public interest to keep the public in the dark regarding the actual quantities of bonds traded.

Moreover, there is no justification for the disparate treatment provided to different grades of corporate bonds (or to other types of debt securities) with respect to these dissemination caps. Since there is more fluctuation in prices in the non-investment grade bond market, dissemination caps permit uncompetitive bond dealers to provide poorer executions, resulting in higher uncompetitive mark-ups if trade information is kept from the public eye.

Rule Enforcement is a Poor Alternative to Competition

Faced with the competitive pressure resulting from full dissemination, bond dealers would be forced to provide better service and maintain competitive prices. Furnishing a trade report to FINRA so that FINRA may observe patterns of trading and otherwise conduct surveillance of the market at levels above the dissemination cap is not sufficient to protect the investing public. FINRA cannot cause orders to be sent to bond dealers providing the best executions. The information contained on the trade report, regardless of the size of the trade, and regardless of the percentage of trades affected, must also be disseminated so that the investing public can monitor the behavior of their brokers and direct orders to those brokers who best represent their interests. We submit that competitive pressures are much more effective than enforcement procedures when it comes to ensuring best execution. We strongly believe that the failure to disseminate complete volume information on debt transactions is detrimental to the investing public and the marketplace for debt securities. This failure to disseminate provides large bond dealers an unfair advantage over the smaller investor and the marketplace in general. Removal of the dissemination caps would expose very valuable information and would put investors in a position to know who is charging the best price. The transparency that would be provided by complete dissemination of trade information would greatly enhance the ability of investors to monitor the debt markets, and the resulting competitive marketplace would lead to more precise valuations, better pricing, and reduced investor costs. As investors gravitate towards the dealers providing the best executions, all other bond dealers will be forced to reduce their prices or improve their service to compete. The transparency provided by removal of the dissemination caps will inspire innovation, level the playing field among broker-dealers with respect to executions, and enhance best execution practices in the industry.

We respectfully request that the FINRA eliminate its policy of capping the trade volume information that is disseminated in its TRACE system, for all debt securities. The dissemination caps are inconsistent with FINRA Rule 6750 and impede free and open markets in debt securities. Dissemination will not create any additional burden on FINRA members from a reporting standpoint, as this information is already being reported to

FINRA. Accordingly, FINRA should amend its protocol and disseminate complete volume information on debt transactions (including 144A transactions) to the investing public.

We greatly appreciate the opportunity to comment. I can be reached at (914) 220-1919 or via email at bnlowson@nelsonlf.com if you have any questions.

Respectfully submitted,

A handwritten signature in black ink that reads "Beth Lawson". The signature is written in a cursive, flowing style.

Beth N. Lawson