



## Fixed Income Conference

New York, NY Tuesday, March 10, 2015

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### **Examination and Enforcement Updates**

**9:10 a.m. – 10:25 a.m.**

This session covers FINRA's fixed income-related examination priorities, findings and enforcement cases. Panelists highlight common exam findings and share lessons learned from recent enforcement cases.

**Moderator:** Patrick Geraghty  
Vice President, Fixed Income  
FINRA Market Regulation

**Panelists:** John Hickey  
Deputy District Director  
FINRA

Susan Light  
Senior Vice President  
FINRA Enforcement

David Rosenstein  
Senior Vice President and Counsel  
FINRA Market Regulation - Legal

## Examination and Enforcement Update Panelist Bios:

Moderator:

**Patrick Geraghty** is Vice President, Fixed Income, Offerings and Customer Issues Group, in FINRA's Market Regulation Department. In his current capacity, Mr. Geraghty oversees the fixed income groups, which conduct markup reviews and data-integrity surveillance for corporate, agency, asset-backed and municipal securities. He served in the same role at NASD before its 2007 consolidation with NYSE Member Regulation, which resulted in the formation of FINRA. Previously, Mr. Geraghty managed the trading practices and customer issues sections, which conduct surveillance for best execution, limit order protection and ITS/CAES trade-throughs, along with providing secondary offering surveillance under Regulation M. Upon joining NASD in 1995, he worked in the real-time surveillance area, handling backing-away complaints, trade-reporting questions and locked/crossed market issues. Mr. Geraghty also served as an advisor to the NASD Series 55 Committee during the development of the question bank for the exam. He has a bachelor's degree in economics from Duke University.

Panelists:

**John Hickey** is the Deputy District Director for the FINRA New York District Office. He supports the Director in leading and managing the Cycle and Branch regulatory programs for approximately 1000 member firms. Additionally, he works with the Regional Director, District Director, Associate District Directors and Surveillance Directors to develop and implement strategic and tactical measures necessary to ensure timely, high-quality completion of District's regulatory programs. Prior to this role, he served as an Associate Director at FINRA and managed a unit of approximately 23 individuals responsible for conducting cycle, cause and branch examinations of several member firms. Mr. Hickey has over 16 years of regulatory experience while employed at FINRA and prior to that at NASD and has worked as an examiner, supervisor and manager during his career. Before joining NASD, he spent three years in the Operations Department at a clearing firm, where he worked in the Margin Department. Mr. Hickey has a B.S. in Management from University of Rhode Island. Mr. Hickey also holds the Certified Regulatory and Compliance Professional™, CRCP™ designation.

**Susan (Sue) Light** has been a senior vice president in the Department of Enforcement of the Financial Industry Regulatory Authority ("FINRA") since the integration of the NASD and portions of NYSE Regulation on July 30, 2007. Prior to the consolidation, she served as senior vice president and department head in the Division of Enforcement of New York Stock Exchange Regulation. She is responsible for managing attorneys and investigators who investigate and prosecute violations of FINRA rules and federal securities laws. Ms. Light supervises such matters as financial and securities fraud, money laundering, subprime and auction rate securities, Regulation SHO, insider trading, stock manipulation, sales practice violations, mutual fund abuses and financial and operational violations. She serves on many regulatory panels on Enforcement topics. Prior to joining the Exchange in 1988, Ms. Light was a prosecuting attorney and supervisor in the Bronx District Attorney's office for seven years. She received her Honors B.A. in 1975 from the University of Michigan, her J.D. in 1981 from Boston University School of Law, and her LL.M. in 1986 from

New York University School of Law. Ms. Light has received the YWCA Women's Achiever Award and the Department of Defense Patriotic Employer award.

**David Rosenstein** is a 1988 graduate of St. John's University where he was an editor of the St. John's Journal of Legal Commentary. Following law school, he worked in the Compliance Department at a major broker dealer located in New York. For over the last twenty-five years, Mr. Rosenstein has held a variety of positions with FINRA, the former NASD, and its affiliated companies, including: Head of the Enforcement Department at the American Stock Exchange, Co-Head of NASD's Amex Options Regulation Division, Head of FINRA's Market Regulation Legal Section and, since the integration with NYSE Enforcement in 2010, Senior Vice President and Deputy for the combined FINRA Market Regulation Legal team. During his twenty-five year plus legal career, and in his various roles at FINRA, Mr. Rosenstein has been instrumental in initiating numerous high-profile cases against firms and individuals alike which have resulted in sanctions of hundreds of millions of dollars. He has spent nearly his entire legal career dedicated to the mission of investor protection and market integrity. Mr. Rosenstein is a participant on various committees at FINRA, including FINRA's Market Regulation Committee and Officer Job Evaluation Committee, and he has been a speaker and panelist at numerous conferences, panels and off-sites.

**Examination and Enforcement Update**

**FINRA Fixed Income Conference  
March 10, 2015 • New York, NY**



**Member Regulation Examination Update**



## 2015 Examination Priorities – Recurring Challenges

- Putting customer interest first
- Firm Culture
- Supervision, risk management and controls
- Product and service offerings
- Conflicts of Interest



## 2015 Fixed Income Examination Priorities and Areas of Focus

- Retail sales of interest rate sensitive products
- Excessive Trading and Concentration controls
- Minimum Denomination Bonds
- Municipal Shorts
- Trade Reporting- Questionable Trade Status
- Primary Offering Practices
- SEA Rule 15c3-5 on direct or sponsored market access
- Municipal advisor activities



## Retail Sales of Interest Rate Sensitive Products

- Suitability
- Disclosure of material risks
- Concentrations in longer duration instruments
- Training of registered representatives
- Policies and procedures



## Minimum Denominations – Municipal Bonds

### MSRB Rule G-15(f) Minimum Denominations

- Dealers may not effect a customer transaction in Municipal Bonds below the minimum authorized denomination for an issue, as stated within the Official Statement, with the following limited exceptions:
  - G-15(f)(i) states:
    - a) only applies to Municipal Securities issued after June 1, 2002
  - G-15(f)(ii)
    - a) Only applies a customer request to liquidate the clients entire position which already exists below the minimum denomination for the issue



## Minimum Denominations – Municipal Bonds

- G-15(f)(iii)
  - a) Allows a Dealer to sell securities to a customer below minimum if the securities were purchased from another customer in liquidating their entire position, and:
  - b) The selling dealer provides the purchaser with a written statement informing the customer that the position being purchased is below the minimum denomination and that this may “adversely affect the liquidity of the position unless the customer has other securities from the same issue that can be combined to reach the minimum denomination” at or before the time of trade execution.

The written statement can be included on the customer trade confirmation or via a separate document.



## Municipal Short Positions

### ■ In 2013 FINRA uncovered some clearing firms with short, naked municipal positions

- Potential net capital impact
- Customers receiving manufactured interest

### ■ Relevant MSRB Rules for consideration

- MSRB G-8 Books and records
- MSRB G-17 Conduct of municipal securities business
- MSRB G-27 Supervision

- SEC Net Capital and Possession and Control Rules

– As reminder, FINRA Rules do not apply to municipal securities.  
See FINRA Rule 0150.



## Causes and Issues of Municipal Shorts

- **A member firm may create naked short municipal positions for a variety of reasons:**
  - Duplicate transaction
  - Bond in process of redemption or call
  - Branch or trading error
- **A series of MSRB and IRS rule violations may occur if:**
  - the firm is unable to cover the short or borrow the bonds, and
  - the bonds are long in the account of a customer who seeks tax exempt income.
- **Characterizing the payment of interest to the clients as tax-exempt represents “manufactured interest.”**

## Practices and Controls related to Municipal Shorts

- **The level of the firm’s awareness and supervision of the issue**
- **The existence and quality of WSPs**
- **Length of time shorts are outstanding**
- **Number and dollar amount of shorts relative to firm’s size**
- **Rigor in attempting to cover the short**
- **Effort to reduce customer harm by swapping to a comparable security**
- **Corrective action, or lack thereof**
- **Willingness to self-report to IRS**

## Trades with a Questionable Status from the MSRB

MSRB Rule G-14 requires firms to report both sales and purchases of municipal bonds to the MSRB generally within 15 minutes of trade execution

Upon reporting the trade to the MSRB a validation of trade data is performed systemically that will result in 3 possible responses:

1. Acknowledged
2. Questionable
3. Rejected



## Trades with a Questionable Status (Continued)

A firm must have a process in place that reviews trades with a Questionable or Rejected status to ensure the accuracy of their trade reporting.

A trade with either a questionable or rejected status does not necessarily mean that the firm made a mistake and must take corrective measures.

However the firm must have a process in place to:

- a) review these trades to ensure the accuracy of the original trade report, or;
- b) take timely action to correct information deemed to have been initially reported inaccurately.

The firm must have a process in place to review all questionable and rejected trades at least daily. This process must be documented and reviewed by a supervisor.

Failure to perform a timely review of trades with a questionable or rejected condition from the MSRB, as well as a supervisory review of the same would be violations of MSRB rule G-14-(b)(ii) and G-27.



## Primary Offering Practices

- **Honoring issuer retail order periods**
  - **MSRB Rule G-8 Books and Record**
    - Underwriters must document and retain all terms and conditions required by the Issuer, including retail order period, if applicable;
    - Underwriters must document and validate that retail orders and allocations comply with the terms and conditions required by the Issuer;
    - The information required under MSRB G-11(k) will be used by examiners to effectively review compliance with the terms and conditions of the retail order period.
- **Timely and accurate submission of offering documents under Rule G-32(b)**
  - Access equals delivery of official statement under Rule G-32(a)
- **Review of issuer's continuing disclosure practices and other underwriter due diligence**

## Summary of SEA Rule 15c3-5 on Market Access

- **Requires broker-dealers with access to trading directly on an exchange or alternative trading system (ATS), including those providing sponsored or direct market access to customers or other persons, to implement risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory and other risks of this business activity.**
- **If your firm has access to trading on an ATS, whether for customer, proprietary, or principal trades, your firm is subject to the Market Access Rule.**

## What are FINRA Examiners looking for related to Market Access?

- Fixed income market access procedures that incorporate all transactions sent to an ATS
- Reasonably designed capital / credit limits reflective of the relative risks associated with this activity
- Evidence of supervision
- Adequate due diligence over the use of third-party service providers
- Periodic testing of systemic controls
- Annual CEO certification
- **TIP** – Once the exam is announced, providing the exam team with a flow chart of your firm's trade flow for each ATS utilized will help facilitate the examination.

## What's new for Municipal Advisors in 2015?

### Rules

- MSRB Rule G-8 – Books and Records to be made by Brokers, Dealers, Municipal Securities Dealers and Municipal Advisors – effective 4/23/15
- MSRB Rule G-9 – Preservation of Records – effective 4/23/15
- MSRB Rule G-44 – Supervisory and Compliance Obligations of Municipal Advisors – effective 4/23/15

### Practices

Firms should review their client accounts to verify whether they handle any accounts for Municipal Entities and, if so, are properly registered as a Municipal Advisor

Examiners will be reviewing and validating any representations of exclusions to the Municipal Advisor rules made by firms.

Any firm that is not registered as a Municipal Advisor must have a supervisory process and controls in place to ensure that the firm does not cross the line and act as a Municipal Advisor while not registered as such.

## Enforcement Update



### 2015 Fixed Income Enforcement Priorities

#### ■ Excessive Markups

#### ■ Suitability

- Risky Products

- Interest Rate Sensitive Fixed Income Securities, Baby Bonds, Illiquid Bonds, Securities Backed Lines of Credit, Sinking Funds & other complex products

- Vulnerable Customers

- Unsophisticated, Elderly, Affinity

#### ■ Supervisory Procedures

- FINRA 3010 & MSRB G-27

#### ■ Disclosure

#### ■ Due Diligence



## Notable FINRA Municipal Securities Enforcement Cases 2014-15



### Department of Enforcement v. Anthony A. Grey,

#### ■ Issue:

- Whether municipal bond transactions with **markups** between 5.36% and 19.12% were “**excessive**” and
- Whether moving the securities through the representative’s personal account constituted **interpositioning** and **fraud**?

■ **MSRB Rule G-17** requires each broker, dealer, municipal securities dealer and municipal advisor to “deal fairly with all persons” and “not engage in any **deceptive, dishonest, or unfair practice.**”

■ **MSRB Rule G-30** requires dealers to trade with customers at prices that are “**fair and reasonable**”.

■ **Section 10(b)** of the Exchange Act - fraud

■ **Penalties:** Hearing Panel fined Grey \$30,000, ordered \$16,000 disgorgement, and suspended him for 24 months.

## Grey (cont.) → “FAIR and REASONABLE”

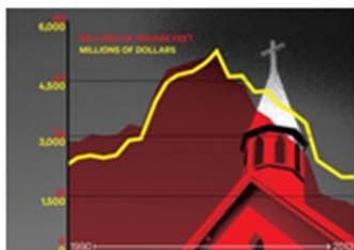
- MSRB's interpretation of “fair and reasonable”
  - Price must be **reasonably related** to the market value
  - Mark-up or mark-down must not exceed a **fair and reasonable** amount (no benchmark or specific percentage provided)
  - Firm had internal limits of 3% (customary for municipal securities)
- Oct. 3, 2014, NAC: fined Grey \$30,000, ordered \$15,750 disgorgement, and suspended him for 18 months
- Fraud - 10(b) and 10b-5 Violations affirmed
  - Panel found scienter by registered representative by “**knowingly or recklessly**” charging **markups over 8.62%** and by **interpositioning**
- Oct. 31, 2014, Grey Appealed the NAC Decision to the SEC

## Best Execution and Excessive Fees

- Fidelity Brokerage Services, LLC
- Inadequate supervisory systems and procedures to monitor fees
- Firm overbilled more than 20,000 customers about \$2.4m including in fixed income securities
  - NASD Rule 2110 and 3010, FINRA Rule 2010, and MSRB G-17 and G-27
  - AWC – Voluntary reimbursement of \$2,418,155, censure and \$350,000 fine



## Affinity Offerings



### ■ B.C. Ziegler

- Church Bonds secondary market
- Failure to Supervise
- Advertising violations; disclosures not fair and balanced
  - NASD Rule 2210(d)(1), MSRB Rule G-21
- AWC – censure & \$150,000 fine

### ■ Concerns and Ongoing Cases

- Bonds sold for Faith-based projects
- Due Diligence
- Advertisements that are not fair and balanced



## Sovereign Debt Issues

### ■ AML Concerns

#### • Global Financial Services, LLC

- Firm failed to have procedures to detect suspicious activity.
- Venezuelan debt liquidated into USD
- AWC - Censure & \$100,000 fine



### ■ Puerto Rican Bonds

#### • Undisclosed Markups

#### • Suitability of Concentrated Positions

##### – Oriental Fin. Servs. Corp.

- AWC – Censure & \$245,000 fine

#### • Suitability of Concentrated Positions

##### – Popular Securities

- AWC – Censure & \$125,000 fine



## Other Areas of Focus

### ■ Muni Shorts

- Large brokerages maintaining short positions in municipal bonds against customer's accounts

### ■ Due Diligence Standards

### ■ Overcharging school district for underwriting services

### ■ Bribery

- Gary Cabello
- Bribing school district board and community college board for underwriting business
  - AWC - Violated MSRB G-17; Bar



## Market Regulation Update



## Transaction Reporting Areas of Focus

- **Reviewing processes and procedures for booking and reporting transactions to RTRS and TRACE**
  - Accuracy of reported execution times for customer transactions
  - Documentation of execution times on books and records
- **Supervisory procedures for firms with prior disciplinary history related to inaccurate or timely reporting**
  - Documentary evidence of the firm's supervisory review
- **Municipal Bonds with minimum denominations**

## Transaction Reporting Areas of Focus

- **P1/S1 reporting for ABS transactions effective April 27, 2015**
- **Reporting of transactions with Investment Advisors**
  - Refer to FAQ 1.51 under Reporting of Corporate and Agencies Debt FAQs
- **Accuracy of capacity reported to TRACE**
  - Firms mismarking trades as agent when in fact trades are executed as principal and include a markup/markdown

## Compliance Rates

- TRACE Corporate – 98.3%
- TRACE Agency – 98.2%
- TRACE SP – 98.4%
- Municipal Bonds – 99.2%
- Continued improvements with regard to the accuracy of execution times in inter-dealer transactions and accuracy of counterparties in inter-dealer transactions

## Fixed Income Investigations

- **Potential misrepresentations in transactions in structured products**
  - Reviewing communications with clients (e.g., Bloomberg chats, e-mails, etc..)
  - Expectations of clients with regard to compensation
  - Supervisory procedures for reviews of communications with clients
- **Wash Sales or Pre-arranged transactions**
  - Painting the tape
  - Resetting the age of an inventory position

## Fixed Income Investigations

### ▪ Best Execution

- FINRA Rule 5310.06 Supplementary Material – Written policies and procedures in place that address how the member will determine the best inter-dealer market for such a security in the absence of pricing information or multiple quotations and must document its compliance with those policies and procedures.

### ▪ Fair Pricing

- Written supervisory procedures and/or exception reports focus reviews solely on markups in excess of 5% guideline.



## Market Regulation Legal Section Update



## Legal Section – Who We Are

### ■ Lawyers Located in Maryland, New York, Illinois and Pennsylvania

- Staff attorneys in Rockville (21), New York (12), Chicago (6), and Philadelphia (1)
- Staff attorneys report to one of eight chief counsels located in Rockville (4), New York (3) and Chicago (1)
- Head of Legal is Robert Marchman and Deputy is David Rosenstein

### ■ Bring enforcement cases on behalf of Quality of Markets Department (includes Fixed Income)

### ■ Cases relate to customer protection, sales practice and market integrity issues



## Legal Section – What We Do

### ■ Snapshot of 2014

- Issued:
  - 360 Letter of Acceptance, Waiver and Consents (AWCs) & Decisions
  - 46 Minor Rule Violation Letters (MRVs)
  - 16 Formal Complaints Filed
  - 199 Cautionary Action Letters (CALs)
- Fines for TRACE reporting violations were \$975,000
- Fines for fair pricing and best execution violations for TRACE-eligible products were \$2.56 million
- Fines for MSRB reporting and pricing violations were \$245,000
- Restitution paid to customers in fixed income matters was nearly \$600,000



## Overview of Disciplinary Process

### ■ Disciplinary Process Milestones

- Initial Notification to firm that matter referred to Legal
- Staff attorneys review alleged violations and entire file gathered to date including 8210 correspondence with the firm
- Firm offered opportunity to make Wells submission
- Staff attorneys recommend outcomes in accordance with FINRA's Sanction Guidelines:
  - Scope and duration of violations
  - Whether firm had reasonable supervisory controls in place
  - Whether misconduct was due to intentional, reckless or negligent acts
  - Other considerations published in FINRA's Sanction Guidelines
- Recommendations are reviewed by management for reasonableness and consistency

## Overview of Disciplinary Process

### ■ Disciplinary Process – Factors Considered

- Staff attorneys consider all factors put forth by the firm, including:
  - the firm's disciplinary history,
  - the firm's subsequent performance in connection with rule violations being considered,
  - the firm's non-compliance rate,
  - performance as compared to peer group.

## Investigations

### ■ Conduct investigations in more egregious matters

- Many investigations focus on fair pricing and best execution rule compliance.
- May involve on the record testimony of traders, reps and supervisors.
- Staff attorneys may also examine the firm's supervisory policies, procedures and systems.

## Factors Considered in Fixed Income Matters

### ■ Fair Pricing Matters

- Factors outlined in FINRA Rule 2121 and MSRB Rule G-30
- Firm's pricing compared to industry — outliers identified
- Magnitude of difference between firm's markup / markdown and those charged by other market participants

### ■ Best Execution Matters

- Reasonableness standard
- Steps taken by firm to arrive at price to customer
  - Documentation to support such steps are relevant
- Extent of violations — isolated vs. systemic violations
- Effect and extent of market factors such as market volatility and liquidity

## Factors Considered in Fixed Income Matters

### ■ Transaction Reporting

- Number of violations — absolute numbers
- Non-compliance percentage rates
- Non-compliance rates compared to peer firms
- Systemic non-compliance evidenced by poor disciplinary history and subsequent performance
- Sufficiency of firm's written supervisory procedures (WSPs)
- Evidence of firm's enforcement of WSPs

## 2014 Significant Matters & Initiatives

### ■ Municipal Bond Minimum Denomination Cases (Ongoing)

- Municipal bond offerings include a minimum denomination that establishes the smallest amount of the bonds a dealer is allowed to sell to an investor in a single transaction.
- Issuers often set high minimum denomination amounts for distressed or other risky bonds that have higher default risks.
- MSRB Rule G-15(f). Investor protection rule.
- The minimum denomination standard helps ensure dealer firms only sell high-risk securities to investors who are capable of making sizeable investments and can bear the higher risks.
- Market Regulation Legal has over 15 open matters involving firms who potentially sold municipal securities in amounts below the minimum denomination amount determined by the issuer at the time of issuance.
- Initiative follows a November 2014 action by the SEC against 13 firms for violating the minimum denomination standard in connection with the sale of Puerto Rico junk bonds to investors in amounts below \$100,000. Firms were fined \$54,000 to \$130,000.

## 2014 Significant Matters & Initiatives

- **Merrill Lynch, Pierce, Fenner & Smith Incorporated (December 2014)**
  - Merrill Lynch charged excessive markdowns to customers in 716 retail customer transactions between 2009 and 2011.
  - **Securities Involved distressed or lower priced securities: Motors Liquidation Company Senior Notes (MLC)**
    - The 710 transactions were purchases from retail customers at prices 5.3 percent to 61.5 percent below prevailing market prices.
    - In 510 instances, the firm's markdowns exceeded 10 percent.
    - The 716 purchases of MLC notes were at prices not fair to its retail customers.
    - The firm did not conduct post-trade best execution or fair pricing reviews of these or other retail transactions at the firm's Global Banking & Markets Credit Trading Desk.
  - Staff factored the nature of the securities and the market for these types of securities into its analysis.
  - Firm fined \$1.9 million for violating NASD Rule 2440 and related supervisory rules and ordered to pay \$540,000 in restitution.
  - Related matters are ongoing.



## 2014 Significant Matters & Initiatives

- **NEXT Financial Group, Inc. (December 2014)**
  - Next Financial charged excessive markups/markdowns to customers in 19 transactions between July 2010 and December 2011.
  - **Securities Involved exempted Agency Securities**
    - NASD Rule 2440, IM-2440-1 and IM-2440-2 (now FINRA Rule 2121) do not apply to exempted securities.
    - Matters pursued as violation of FINRA Rule 2010 (see NTMs 96-99, 07-28, at n.6).
    - Still review factors for fairness of markup/markdown: (1) type of security involved; (2) availability of security in the market; (3) the amount of money involved in the transaction; and (4) disclosures made to the customer, if any, regarding the markup before the transaction is executed.
    - Next's markups/markdowns ranged from 2.5% to 3.02%, involved large institutional sized dollar amount transactions and the agency securities were readily available in the market.
    - Comparable markups/markdowns charged by other broker-dealers were as low as .53%.
  - Firm claimed that significant additional services provided to these institutional customers justified higher markups. Claim was not fully substantiated. NEXT had provided services to these customers, but before the transactions in issue. Bona fide services will be taken into account in determining a fair markup/markdown.
  - Firm was censured, fined \$265,000 and ordered to pay restitution in the amount of \$177,170.



## Significant Matter Update - 2015

### ■ Robert Marcus Lane and Jeffrey Griffin Lane

- Lane brothers owned Greenwich High Yield, LLC
- In 11 instances, Marcus Lane purchased distressed corporate bonds from a broker-dealer, sold to an entity he controlled, purchased the same bonds back, and sold the bonds to his customers.
  - In each leg, the bonds were marked-up.
  - Each 4-legged trip completed typically within one hour.
  - Jeffrey Lane responsible for supervising Marcus Lane.
- The aggregate mark-up of the bonds charged to customers ranged from 6.45 percent to 40.93 percent.
- Marcus Lane ordered to disgorge \$218,582, plus interest.
- Marcus and Jeffrey Lane barred from the financial industry.
- On February 13, 2015, the SEC sustained FINRA's action, including the sanctions imposed, on Marcus Lane for his interpositioning conduct, on Jeffrey Lane for his failure to supervise and on the two of them for impeding an investigation.
- The SEC agreed with the NAC that "the degree of regulatory pressure required to obtain a response 'was substantial and is a highly aggravating factor.'"



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### Examination and Enforcement Updates

#### Resources

##### General

- FINRA 2015 Annual Examination Priorities Letter

<http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p602239.pdf>

##### Member Regulation

- MSRB Notice 2013-08, “MSRB Answers Frequently Asked Questions (FAQs) Regarding an Underwriter’s Disclosure Obligations to State and Local Government Issuers Under Rule G-17”

[www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-08.aspx?n=1](http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-08.aspx?n=1)

- MSRB Notice 2012-38, “Guidance on Implementation of Interpretive Notice Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities”

[www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-38.aspx?n=1](http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-38.aspx?n=1)

- MSRB Notice 2012-25, “Securities and Exchange Commission Approves Interpretive Notice on the Duties of Underwriters to State and Local Government Issuers”

[www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-25.aspx?n=1](http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-25.aspx?n=1)

- Risk Management Controls for Brokers or Dealers with Market Access (SEC Release 34-64748)

[www.sec.gov/rules/final/2011/34-64748.pdf](http://www.sec.gov/rules/final/2011/34-64748.pdf)

##### Enforcement

- B.C. Ziegler (2011028571401)

<http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=36422>

- Cabello, Gary (2012032456001)

<http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=35734>

- Fidelity Brokerage Services, LLC (2012034916901)

<http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=38474>

- Global Financial Services, LLC (2012030724501)

<http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=37809>

- Grey, Anthony (2009016034101)

<http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=37660>

- Oriental Financial Services Corp (2013035308801)

<http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=38191>

- Popular Securities Inc (2013035309401)

<http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=38192>

## **Market Regulation**

- FINRA Regulatory Notice 14-53, "FINRA Reminds Alternative Trading Systems (ATSs) and ATS Subscribers of Their Trade Reporting Obligations in TRACE-Eligible Securities"

<http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p601788.pdf>

- FINRA Regulatory Notice 14-34, "SEC Approves Amendments to Disseminate Additional Asset-Backed Securities Transactions and to Reduce the Reporting Time for Such Transactions"

<http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p582849.pdf>

## **Market Regulation Legal Section**

- FINRA Sanction Guidelines

[www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf](http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf)

- FINRA Fines Merrill Lynch \$1.9 Million and Orders Restitution of \$540,000 for Fair Pricing and Supervisory Violations Related to Purchases of Distressed Securities

<http://www.finra.org/Newsroom/NewsReleases/2014/P602102>

- NEXT Financial Group, Inc. (2011026521101)

<http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=38220>

- SEC Sanctions 13 Firms for Improper Sales of Puerto Rico Junk Bonds

<http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543350368>

- Securities and Exchange Commission Decision: Release No. 74629/February 13, 2015/Administrative Procedure File No. 3-15701

<http://www.sec.gov/litigation/opinions/2015/34-74269.pdf>



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### **Risk Management for Institutional Firms**

**10:40 a.m. – 11:55 a.m.**

This session focuses on effective risk management practices for institutional firms. Panelists share processes to identify, assess, mitigate and manage risk. They discuss how to prioritize risks and determine which are of the highest priority. The panel also reviews effective internal controls and methods on how to keep policies and procedures up to date with fixed income regulatory developments.

**Moderator:** Anand Ramtahal  
Senior Vice President  
Member Regulation – Risk Oversight and Operational Regulation, FINRA

**Panelists:** Matt Leisen  
Managing Director  
Goldman Sachs & Co.

Jeremy Smith  
Head of Wholesale Market Risk  
Wells Fargo Securities LLC

Donald Winton  
Vice President and Chief Operating Officer  
Crews & Associates, Inc.

## Risk Management For Institutional Firms Panelist Bios:

Moderator:

**Anand Ramtahal** is Senior Vice President in the Risk Oversight and Operational Regulation Department, within Member Regulation, at FINRA. Mr. Ramtahal is responsible for the Financial and Operational Examination and Surveillance Programs for approximately 200 members that conduct a public customer business. Mr. Ramtahal joined NYSE Regulation in May 1984, and held various positions in the division of Member Firm Regulation, most recently as Vice President. He became associated with FINRA in July 2007, after the consolidation of the NASD and certain divisions of NYSE Regulation. Prior to joining NYSE Regulation, Mr. Ramtahal spent four years in the securities industry as an accountant with The Wilsher Group and Paine Webber Inc. Mr. Ramtahal graduated from Pace University with a bachelor's of business administration in public accounting and earned a master's in business administration in finance from Long Island University.

Panelists:

**Matt Leisen** is a managing director in the Corporate Treasury Department. He leads cash and collateral management in New York and has been focused on significant efficiency efforts and risk management initiatives since 2011. Mr. Leisen serves on the Clearing House Risk Committee, the Bank Finance Subcommittee and the Bank New Activity Committee. Prior to his role in Corporate Treasury, he spent several years in the Securities Division, working on product development for the Repo desk. He joined Goldman Sachs in 2002 and was named managing director in 2013. Mr. Leisen earned a BBA in Finance from the University of Notre Dame in 2002.

**Jeremy Smith** is a managing director and Head of Wholesale Market Risk. Based in Charlotte, N.C., he is responsible for all market risk activity across the Wholesale Bank and Corporate Contingent Credit which includes managing credit exposure in the Derivatives Clearing, Interest Rates, and Commodities teams. Prior to assuming his current role in 2011, he was a loan supervisor in Commercial Banking. His responsibilities included credit oversight of several Midwest States, credit policy and portfolio management. Mr. Smith began his banking career with Wells Fargo in 1998. Following various assignments in Commercial Banking, he graduated from the Credit Management Training Program in 2000 and joined the Bellevue Regional Commercial Banking Office (RCBO) as a relationship manager. During his career with Wells Fargo, he has worked in Atlanta, Ga., as a relationship manager with the Real Estate group and as the loan team manager of the Kansas City RCBO. Mr. Smith earned a B.A. degree in economics with a minor in international finance at the University of Washington in Seattle. Born in Totnes, United Kingdom, he has lived and worked in the U.K., Cyprus, Saudi Arabia, Monaco, and various parts of the United States.

**Don Winton**, COO, Crews & Associates, Inc. serves in several principal capacities within their firm which is a bank owned independent broker-dealer. His current responsibilities include managing the Client Services Group for Clearing & Operations. Mr. Winton managed the Taxable Securities trading desk and is actively responsible for personnel, training, branch activity and communication and network systems with the firm. Mr. Winton's participation in the firm's regulatory compliance

agenda with the different governing agencies led him to complete the FINRA Institute Certificate Program at Wharton where he earned his CRCP designation. Mr. Winton served on the FINRA District 5 Committee, currently serves as a FINRA securities industry arbitrator, and also participates in the FINRA District 5 Focus Group in New Orleans. Additional industry participation includes serving as a founding member of the Bond Dealers of America where he will begin a new term on the Board of Directors this spring. In addition, he currently serves on the Executive Committee with the Regional Municipal Operations Association (RMOA).



## Fixed Income Conference

New York, NY Tuesday, March 10, 2015

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### **Fixed Income Compliance Practices at Retail Firms** **10:40 a.m. – 11:55 a.m.**

Join industry panelists as they discuss fixed income suitability and supervision issues, share their firms' practices and how they address investor issues such as compliance with state privacy laws. Hear how firms track regulatory developments, their views on the value of comment letters in the regulatory process and the benefits for firm compliance efforts.

**Moderator:** Bonnie Bowes  
Associate Director, Fixed Income Regulation  
FINRA

**Panelists:** Sarah Gill  
Senior Vice President and Head of Policy, Government Relations  
LPL Financial, LLC

Bradley Treichler  
Vice President  
Fidelity Brokerage Services LLC

William Woodward  
Chief Compliance Officer  
Wunderlich Securities, Inc.

## **Fixed Income Compliance Practices at Retail Firms Panelist Bios:**

Moderator:

**Bonnie Bowes** is the Associate Director of Fixed Income Regulation within FINRA Member Regulation. Ms. Bowes drives key FINRA fixed income initiatives in municipal, corporate and government securities and securitized products. She focuses on the policy and examination implications of current fixed income regulatory matters in order to provide guidance to FINRA staff and member firms. Prior to joining FINRA in 2013, her career encompassed leadership roles in fixed income compliance, operations, product management and credit risk. Ms. Bowes has worked at top-tier wealth management and capital markets broker-dealers, an alternative trading system (ATS) and the Depository Trust and Clearing Corp. (DTCC). She holds a bachelor's degree from the University of Rochester.

Panelists:

**Sarah Gill** is a Senior Vice President and Head of Policy for Government Relations at LPL Financial. In this role, she evaluates and addresses regulatory and legislative proposals that are important to LPL, its financial advisors, and their investors. She also focuses on the firm's strategy for addressing policy issues and its engagement with trade association partners and business unit leaders. Before joining Government Relations, Ms. Gill was a Senior Vice President and Associate Counsel in the Legal Department's Regulatory Affairs Group. She joined LPL in September 2010. Prior to joining LPL, Ms. Gill served as an Assistant General Counsel in the Litigation Group of FINRA's Office of General Counsel. Ms. Gill defended FINRA in federal and state litigation matters, handled internal investigations, and provided advice regarding regulatory and litigation issues. Ms. Gill worked at FINRA from 2007 to 2010. Ms. Gill was a Counsel in the Litigation and Securities Departments at WilmerHale before joining FINRA. She worked in WilmerHale's Washington, D.C. office from 2003 to 2007. From 2001 to 2003, Ms. Gill clerked for the Honorable Ricardo M. Urbina, U.S. District Judge for the District of Columbia. Ms. Gill began her legal career as an officer in the U.S. Navy J.A.G. Corps, with assignments as a prosecutor in Pearl Harbor, Hawaii and a Special Assistant U.S. Attorney at the U.S. Attorney's Office in Honolulu, Hawaii. She left the Navy as a Lieutenant. Ms. Gill obtained her law degree from the UCLA School of Law, where she served as Editor-in-Chief of the UCLA Women's Law Journal. She received her B.A., magna cum laude, from the University of Pennsylvania.

**Bradley (Brad) Treichler** has been employed with Fidelity Investments for over a decade and has been in his current role, working in the retail channel of Fidelity Brokerage Services LLC, as VP Fixed Income Products, since 2006. For most of his tenure in this role, he has served as the firm's Municipal Securities Principal. Mr. Treichler represents Fidelity's retail channel at its governance committees, oversees fixed income trading, and is involved in product and tool enhancements to Fidelity.com, the firm's online platform. Prior to joining Fidelity, he was the Chief Compliance Officer at two firms, JB Oxford and Terra Nova Trading (TNT). In his role at TNT, he also handled all compliance responsibilities for its sponsored ECN, Archipelago. Prior to these compliance roles, He established two FINRA registered broker/dealers, taking both firms through FINRA's filing and membership application process. Mr. Treichler is Registered Principal licensed (Series 4, 8, 24, 27, 53) and FINRA Compliance Official licensed (Series 14).

**William D. Woodward** is the Chief Compliance Officer for Wunderlich Securities, Inc., and has 30 years of experience in the securities industry primarily in compliance and supervision. Mr. Woodward holds Series 7, 4, 24, 27, 53, 63 licenses. Mr. Woodward has spent 10 years as a consultant, providing consulting services to broker/dealers and registered investment advisor firms in the areas of compliance and supervisory controls. These services included but were not limited to: creation and implementation of supervisory procedures; sales practice review; compliance and supervisory training for registered principals; creation of firm element, continuing education policies and procedures; due diligence; complaint review; conduct mock audits for member firms; branch examinations; special investigations regarding sales practices, conversion, mutual fund multi-class issues; 1035 exchanges, churning, suitability, and selling away.

## Fixed Income Compliance Practices at Retail Firms

FINRA Fixed Income Conference  
March 10, 2015 • New York, NY



### Fixed Income Compliance Practices at Retail Firms

- Introduction
- Suitability
- What impacts compliance practices?
  - Rulemaking
  - Enforcement actions
  - Market forces
- Supervision and Surveillance



## Fixed Income Conference

New York, NY Tuesday, March 10, 2015

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### **Key Note Address**

**12:10 p.m. – 12:50 p.m.**

This session covers FINRA's fixed income-related examination priorities, findings and enforcement cases. Panelists highlight common exam findings and share lessons learned from recent enforcement cases.

**Introduction:** Susan Axelrod  
Executive Vice President  
FINRA Office of Regulatory Ops

**Keynote:** Daniel Gallagher, Jr.  
Commissioner  
U.S. Securities and Exchange Commission

## Keynote Bios:

### Introduction:

**Susan F. Axelrod** is Executive Vice President of Regulatory Operations. In this capacity she oversees Enforcement, the Office of Fraud Detection and Market Intelligence, and Member Regulation. Before being named to her current role, Ms. Axelrod was Executive Vice President and head of Member Regulation—Sales Practice, with responsibility for ongoing surveillance and examinations, both routine and investigative, of FINRA-regulated securities firms. She was appointed to this position in July 2010. Previously, Ms. Axelrod was FINRA Senior Vice President and Deputy of Regulatory Operations. Her responsibilities included assisting in the oversight of the Market Regulation, Enforcement and Member Regulation functions at FINRA. She also played a key role in the integration of NASD and NYSE Member Regulation. Prior to joining FINRA in 2007, Ms. Axelrod was Chief of Staff to the CEO of NYSE Regulation for three years. In this position, her responsibilities included overseeing operations on a day-to-day basis and acting as a liaison with various business areas including finance, human resources, government relations and communications. Ms. Axelrod joined the NYSE in 1989 as a Staff Attorney in the division of enforcement and became an Enforcement Director in 1997. Among the cases she handled were those involving specialist and floor broker misconduct, insider trading, upstairs trading, sales practice violations, and financial and operational compliance issues. She received her J.D. from the Hofstra University School of Law in 1989 and her B.A. from Emory University in 1986.

### Keynote:

**Daniel M. Gallagher, Jr.** was confirmed by the United States Senate as a Commissioner of the Securities and Exchange Commission on October 21, 2011 and sworn in on November 7, 2011. Commissioner Gallagher has had the honor and privilege of serving the agency in several capacities throughout his professional career. He first joined the Commission as a summer honors program intern while pursuing his law degree, focusing on enforcement matters. In January 2006, he rejoined the agency, serving first as counsel to SEC Commissioner Paul S. Atkins, and later as counsel to SEC Chairman Christopher Cox, working on matters involving the Division of Enforcement and the Division of Trading and Markets. In 2008, he joined the Division of Trading and Markets as Deputy Director and served as Co-Acting Director of the Division from April 2009 until January 2010. During this period, Commissioner Gallagher was on the front lines in the agency's response to the financial crisis. He represented the Commission in the Lehman Brothers liquidation, and helped lead the agency in addressing other crisis-related issues, including the move to central clearing of swaps and matters involving SIPC. In his role as Co-Acting Director of Trading and Markets, he also served as the inaugural Chairman of Committee 6 of the IOSCO Technical Committee, responsible for addressing matters related to the regulation of credit rating agencies. Since returning to the agency in 2011, Commissioner Gallagher has focused on initiatives aimed at strengthening our capital markets and encouraging small business capital formation, including staunchly supporting the changes introduced by the JOBS Act. Commissioner Gallagher has also been an outspoken and frequent advocate for conducting a comprehensive holistic review of equity market structure issues; increasing the Commission's focus on the fixed income markets, both corporate and municipal; addressing the outsized power of proxy advisory firms; and eliminating special privileges for credit rating agencies. He has also addressed the creeping federalization of corporate governance matters as well as the concerted efforts of special interest groups to

manipulate the SEC's disclosure regime to advance their political agendas. He also has been instrumental in educating the markets and investors about the shortcomings of the Dodd Frank Act and the encroachment of bank regulatory measures and prudential regulators into the capital markets. In addition, Commissioner Gallagher has been an outspoken critic of the disturbing trend toward empowering supranational groups to enact "one world" regulation outside established constitutional processes. While in the private sector, Commissioner Gallagher advised clients on broker-dealer regulatory issues and represented clients in SEC and SRO enforcement proceedings as a partner with the Washington, D.C. law firm WilmerHale, where he earlier began his career in private practice. Commissioner Gallagher also served as the General Counsel and Senior Vice President of Fiserv Securities, Inc., where he was responsible for managing all of the firm's legal and regulatory matters. Commissioner Gallagher earned his JD degree, magna cum laude, from the Catholic University of America, where he was a member of the law review. He graduated from Georgetown University with a BA degree in English.



## Fixed Income Conference

New York, NY Tuesday, March 10, 2015

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### **Municipal Securities**

**2:00 p.m. – 3:15 p.m.**

This session addresses regulatory developments with respect to both municipal securities broker-dealers and municipal advisors, including new, amended and proposed MSRB rules. Panelists discuss new continuing education requirements for municipal securities representatives, as well as new supervisory and compliance obligations for – and the extension of – existing rules to municipal advisors. The MSRB also discusses their plans to enhance transparency through a centralized platform.

**Moderator:** Cynthia Friedlander  
Director  
Fixed Income Regulation, FINRA

**Panelists:** Jessica Kane  
Deputy Director  
U.S. Securities and Exchange Commission

Rebecca Lawrence  
Managing Director and Council  
Piper Jaffray & Co.

Michael Post  
General Counsel – Regulatory Affairs  
Municipal Securities Rulemaking Board

## **Municipal Securities Panel Bios:**

### Moderator

**Cynthia Friedlander** is the Director of Fixed Income Regulation within FINRA Member Regulation. Ms. Friedlander is responsible for directing FINRA's policies and national programs related to fixed income securities, including related regulatory matters in FINRA District Offices. Specifically, she is responsible for the design, development and delivery of fixed income policy guidance to staff throughout FINRA, as well as to member firms, and is one of FINRA's primary representatives in fixed income regulatory matters with the Municipal Securities Rulemaking Board (MSRB) and the Securities and Exchange Commission (SEC). Ms. Friedlander represents FINRA at government agency, SRO and industry and advisory meetings, and is a staff liaison to FINRA's Fixed Income Committee. She holds a bachelor's degree from the University of Virginia and an M.B.A. from George Mason University.

### Panelists

**Jessica Kane** is the Deputy Director of the Office of Municipal Securities (OMS) at the U.S. Securities and Exchange Commission (SEC). OMS is responsible for coordinating the SEC's municipal securities activities, advising the Commission on policy matters relating to the municipal securities market, and providing technical assistance in the development and implementation of major SEC initiatives in the municipal securities market. As a member of OMS, Ms. Kane has been actively involved in developing recommendations to the Commission for the final rules for municipal advisor registration and implementing those final rules, including developing staff interpretive guidance and reviewing rules for municipal advisor regulation proposed by the Municipal Securities Rulemaking Board. Before joining OMS, Ms. Kane worked in the Division of Corporation Finance and the Office of Legislative and Intergovernmental Affairs at the SEC. Ms. Kane holds a bachelor's degree from Georgetown University and a law degree from George Mason University School of Law.

**Rebecca Lawrence** is a managing director and assistant general counsel at Piper Jaffray & Co., a leading middle markets investment bank headquartered in Minneapolis, Minnesota. Ms. Lawrence provides legal support for sales, trading and underwriting of municipal bonds and other fixed-income products, municipal advisor activities, derivatives and commercial lending. She also manages regulatory actions and litigation for the firm in these areas. Ms. Lawrence previously served at RBC Capital Markets in the same capacity and as a bond lawyer in private practice at Dorsey & Whitney LLP. She also served as a financial advisor for an independent non-dealer financial advisor and as an analyst in the debt management division of a large issuer. Ms. Lawrence chaired the Securities Industry and Financial Markets Association (SIFMA) Municipal Legal Advisory Committee and has held board positions locally. She has a JD from the University of Minnesota and an MPA from Indiana University.

**Michael L. Post** is General Counsel-Regulatory Affairs of the Municipal Securities Rulemaking Board (MSRB), where he is a legal and policy advisor to the MSRB and its Board of Directors. He manages the development of regulations governing municipal securities dealers and municipal advisors in support of a fair and efficient municipal securities market. Prior to joining the MSRB in 2013 as Deputy General Counsel, Mr. Post served for more than 10 years at the U.S. Securities

and Exchange Commission. From 2007 to 2009, he was counsel to former Chairs Christopher Cox and Mary Schapiro, assisting with the development and implementation of an agency-wide regulatory agenda. In that capacity, Mr. Post advised on a broad range of legal, policy and management issues arising primarily out of the Divisions of Trading and Markets and Enforcement as well as the Office of the General Counsel and Office of Municipal Securities. He also assisted with the SEC's response to the financial crisis of 2008. From 2009 until 2013, Mr. Post served as a senior appellate litigator in the SEC Office of the General Counsel, representing the SEC in the Circuit Courts of Appeals and U.S. Supreme Court in matters arising out of rulemakings, enforcement actions and adjudications as well as the SEC's amicus curiae program. He is a recipient of the Manuel F. Cohen Outstanding SEC Younger Lawyer Award from the Securities Law Committee of the Federal Bar Association. Earlier in his career, he was an associate in the Supreme Court and Appellate Litigation Group at Sidley, Austin, Brown & Wood LLP, and a law clerk on the U.S. Court of Appeals for the Tenth Circuit. Mr. Post earned a Bachelor of Arts degree in economics from the University of California, Los Angeles, and a juris doctor, with high honors, from The George Washington University Law School, where he was a senior editor of the *Law Review*.



## Municipal Securities

Michael L. Post  
General Counsel – Regulatory Affairs

FINRA Fixed Income Conference  
Crowne Plaza Times Square Manhattan Hotel  
March 10, 2015



## Municipal Advisor Updates

## Regulatory Framework

- MSRB is developing a comprehensive regulatory framework that includes:
  - Development of rules governing the professional conduct of municipal advisors
  - Establishment of a professional qualifications program that ensures municipal advisors are qualified in their duties
  - Extensive education and outreach to municipal advisors on duties and obligations

## MSRB Municipal Advisor Rulemaking

Rule	Latest Notice	Status
Supervision and compliance obligations (Rule G-44)	<a href="#">MSRB Notice 2014-19</a>	Effective April 23, 2015
Core standards of conduct rule (Rule G-42)	<a href="#">MSRB Notice 2014-12</a>	Preparing SEC rule filing
Political contributions rule (Rule G-37)	<a href="#">MSRB Notice 2014-15</a>	Preparing SEC rule filing
Gifts and gratuities (Rule G-20)	<a href="#">MSRB Notice 2014-18</a>	Preparing SEC rule filing
Professional qualifications (Rule G-3)	<a href="#">SR-MSRB-2014-08</a>	Pending SEC review

## MSRB Rule G-18

### Best Execution

## MSRB Rule G-18: Best Execution

- Effective December 7, 2015, dealers must:
  - Use reasonable diligence to ascertain the best market for the subject security; and
  - Buy or sell in that market to provide the customer the most favorable price possible under prevailing market conditions
- “Market” defined
  - A market encompasses a variety of different venues, including (but not limited to):
    - Broker’s brokers;
    - Alternative trading systems or platforms; and
    - Other counterparties, including a dealer itself acting as principal

## MSRB Rule G-18: Best Execution (*continued*)

- MSRB Rule G-18 applies to both principal and agency transactions
- Best-execution obligations are distinct from the pricing obligations of dealers under MSRB Rule G-30
- A best-execution standard is not a substantive pricing standard, but an order-handling standard for executing transactions

## Reasonable Diligence

- Dealers must use **reasonable diligence** in seeking to obtain for their customer's transactions the most favorable terms available under prevailing market conditions
- Factors to be considered in determining whether a dealer used "reasonable diligence," with no single factor being determinative:
  - Character of the market for the security;
  - Size and type of transaction;
  - Number of markets checked;
  - Information reviewed to determine the current market for the subject security or similar securities;
  - Accessibility of quotations; and

## Reasonable Diligence (*continued*)

- Failure to obtain the most favorable price does not necessarily mean that a dealer failed to use reasonable diligence under the circumstances
- MSRB Rule G-18 does not contain a regulatory standard by which the transaction price is to be evaluated
- A dealer's failure to maintain adequate resources, such as staff or technology, is not an excuse for executing away from the best available market

## MSRB Rule D-15: Sophisticated Municipal Market Professionals (SMMPs)

- MSRB Rule D-15 defines the term SMMP by three essential requirements:
  - *Nature of the customer:* must be a bank, savings and loan, insurance company, or registered investment company; registered investment adviser; or other person or entity with assets of at least \$50 million
  - *Determination of the customer's sophistication:* dealers must have a reasonable basis to believe the customer is capable of independently evaluating investment risks and market value
  - *Customer affirmation:* the customer must affirmatively indicate that it is exercising independent judgment with respect to certain evaluations and that it has timely access to material information available through established industry resources

## Bank Loans and Private Placements

### MSRB Leadership Disclosure of Undisclosed Debt

- MSRB recently renewed its calls for better disclosure of bank loans and other debt-like obligations on **EMMA**<sup>®</sup>
  - [Market Advisory, Jan. 2015](#)
  - [Letter on SEC Rule 15c2-12, Jan. 2015](#)
  - [Notice on Voluntary Disclosure Process, April 2012](#)
  - [Notice on Direct Purchases and Bank Loans as Securities, Sept. 2011](#)



#### MSRB Resources on Bank Loans and Other Debt-like Obligations

The Municipal Securities Rulemaking Board (MSRB) believes that the availability of timely disclosure of additional debt in any form and debt-like obligations is beneficial to foster market transparency and to ensure a fair and efficient municipal market. The MSRB is concerned that investors and other market participants are often unaware of the potential impact of bank loans and other debt-like obligations on the security status of existing bondholders and the credit or liquidity profile of an issuer, among other implications. The MSRB developed the below resources to encourage voluntary disclosure of bank loans and other debt-like obligations of municipal securities issuers.

- **MSRB Market Advisory on Disclosure of Bank Loans**  
January 2015  
The MSRB advocated for enhanced transparency of undisclosed debt and provided best practices to support voluntary disclosure of bank loan information through the MSRB's EMMA website.  
[Read the advisory](#)
- **MSRB Comment Letter on Securities and Exchange Commission Rule 15c2-12**  
January 2015  
The MSRB urged the SEC to amend its municipal market disclosure rule, Rule 15c2-12, and to consider changes to improve its operation and reflect current market practices. The letter encouraged the SEC to look to its disclosure standards for the corporate market as a precedent for disclosure of off-balance sheet obligations such as bank loans.  
[Read the comment letter](#)
- **MSRB Notice Concerning Voluntary Disclosure of Bank Loans to EMMA**<sup>®</sup>  
April 2012  
The MSRB that encouraged state and local governments in 2012 to make information about their bank loans publicly available on a voluntary basis on the EMMA website.  
[Read the notice](#)
- **MSRB Notice on Potential Applicability of MSRB Rules to Certain "Direct Purchases" and "Bank Loans"**  
September 2011  
The MSRB advised the market that bank loans could, depending on the nature of the transaction, be a private placement of municipal securities and therefore subject to specific regulatory requirements, including disclosure. Because determining whether these products are loans or securities is not a straightforward analysis, the MSRB encouraged the SEC to provide further guidance on this issue.  
[Read the notice](#)

## Municipal Securities

Michael L. Post  
General Counsel – Regulatory Affairs

FINRA Fixed Income Conference  
Crowne Plaza Times Square Manhattan Hotel  
March 10, 2015



## Fixed Income Conference

New York, NY Tuesday, March 10, 2015

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### **TRACE Updates**

**2:00 p.m. – 3:15 p.m.**

This session covers recent TRACE developments. Panelists discuss the impact of recent transaction dissemination initiatives (e.g., 144A), particularly on the institutional market.

**Moderator:** Elliot Levine  
Associate Vice President and Counsel  
Transparency Services FINRA

**Panelists:** Ola Persson  
Vice President  
Corporate Debt FINRA

Philip Rothman  
Executive Director  
Morgan Stanley & Co. LLC

Carmine Venezia  
Managing Director  
Goldman Sachs & Co.

## TRACE Update Panelist Bios:

### Moderator

**Elliot Levine** is Associate Vice President, Chief Counsel and Senior Advisor, Transparency Services at FINRA. In his role as Chief Counsel, he provides legal guidance on various aspects of debt and equity market structure and regulation in connection with FINRA's operation of TRACE, ADF and the OTCBB. In addition, Mr. Levine has advised several foreign regulators regarding equity and bond market structure and regulation. Before joining FINRA, Mr. Levine held senior, in-house counsel positions including as assistant general counsel at CIBC World Markets and as equity trading and capital markets counsel at Bear Stearns & Co. In his capacity as in-house counsel, he participated extensively on various FINRA, SIA and BMA committees, including SIA's Capital Markets Committee and as Chair of the BMA's Corporate Bond Legal Advisory Committee. Mr. Levine has extensive regulatory experience, as he has held staff attorney positions in the Division of Market Regulation at the Securities and Exchange Commission and in the Division of Trading and Markets at the Commodity Futures Trading Commission. Mr. Levine attended Trinity College in Hartford, where he received a bachelor's degree in history, and American University, Washington College of Law, where he received his law degree.

### Panelist

**N. Ola Persson** is Vice President, TRACE and Fixed Income Strategy with FINRA Transparency Services. In this role, Mr. Persson manages the TRACE program and oversaw the expansion of TRACE to include securitized products. Mr. Persson joined FINRA in 2004. Prior to joining FINRA, Mr. Persson worked for 10 years at Thomson Reuters, where he held a number of positions in the Fixed Income Division.

**Philip Rothman** is Executive Director and the Co-Head of U.S. Institutional Sales and Trading Compliance for Morgan Stanley & Co. LLC. He attended Cornell University's School of Industrial and Labor Relations and Brooklyn Law School. After graduating from law school in 1995, he worked in private practice for four years as a commercial and corporate litigation attorney. In 1999, he joined the New York Regional Office of NASD Enforcement, where he became a Regional Counsel. Mr. Rothman pursued numerous and varied matters involving violations of SEC and NASD rules, including fraud, unauthorized trading and suitability cases, among others. In 2004, he joined Morgan Stanley as an attorney in the U.S. Litigation Group, where he represented the Firm in regulatory matters brought by various regulators and self-regulatory organizations that focused on the Firm's institutional and retail securities businesses. In 2006, Mr. Rothman joined Morgan Stanley's Institutional Compliance Department, where he managed a group that investigated and responded to regulatory inquiries and examinations, including requests involving various fixed income issues, such as TRACE reporting, fair pricing, mark ups and MSRB rules. In 2010, Mr. Rothman became the head of the U.S. Fixed Income Compliance coverage group, and in 2014, he was named to his current role as Co-Head of Sales and Trading Compliance, in that capacity he is responsible for Compliance coverage for Fixed Income, Equity, Futures and Commodities businesses and products.

**Carmine Venezia** Carmine Venezia is co-head of Americas Securities Division Compliance. He serves as a member of the firmwide Credit Policy Committee, the Global Special Situations Group Investment Committee and the Global Compliance People Development Committee. Mr. Venezia also represents the firm on a number of industry committees, including the FINRA Operations Advisory Committee. He joined Goldman Sachs in 2006 as a vice president and associate general counsel in the Legal Department. In 2009, he joined the Global Compliance Division as the global manager of Operations, Technology, Finance and Services Compliance, a position he held until he assumed his current role in 2014. Mr. Venezia was named managing director in 2012. Prior to

joining the firm, he worked at Bear Stearns & Company as a senior managing director in the Legal Department for ten years. Earlier in his career, Mr. Venezia worked in private practice with a large New York City law firm and before becoming an attorney he was a staff accountant with Price Waterhouse. Mr. Venezia serves as a member of the Board of Trustees of Trinity Hall. He earned a BS in Accounting from Lehigh University in 1988 and a JD from Brooklyn Law School in 1993. He is admitted to the New York and Pennsylvania bars and is a certified public accountant.



## Fixed Income Conference

New York, NY Tuesday, March 10, 2015

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### **Fixed Income Market Structure: Pre- and Post- Trade Disclosures** **3:30 p.m. – 4:45 p.m.**

This session focuses on two FINRA initiatives designed to increase the disclosure of pre- and post-trade information—the proposal requiring ATs to submit quotation information for corporate and agency debt securities, and the proposal requiring firms to disclose additional pricing information for same-day, retail-size principal transactions in corporate and agency debt securities. MSRB staff will discuss their parallel post-trade pricing disclosure proposal. Panelists discuss the potential effects of the proposals, especially the impact on investors and broker-dealers, and possible impacts on regulation and compliance. Panelists also review ways to increase disclosure in the fixed income market with respect to quotation and pricing information.

**Moderator:** Andrew Madar  
Counsel  
Office of General Counsel, FINRA

**Panelists:** Matt Boardman  
Managing Director and Head, U.S. Wealth Management Fixed Income  
RBC Capital Markets LLC

Robert Muh  
Chief Executive Officer  
Sutter Securities, Inc.

Paige Pierce  
President and Chief Executive Officer  
RW Smith & Associates

Michael Post  
General Counsel – Regulatory Affairs  
Municipal Securities Rulemaking Board

John Reilly  
Managing Director, Head of Business & Strategy Capital Markets Trading  
Wells Fargo Advisors LLC

## Fixed Income Market Structure: Pre/Post Trade Disclosures Panelist Bios

**Andrew Madar** is an Associate General Counsel in FINRA's Office of General Counsel, a position he has held since 2013. Prior to that, he was in the Office of Market Supervision in the Division of Trading and Markets at the U.S. Securities and Exchange Commission, where he was an Assistant Director. He obtained his law degree from Fordham University School of Law and a Bachelor of Arts degree in Philosophy from Haverford College.

**Matt Boardman** is responsible for the fixed income business of US Wealth Management, overseeing all products, taxable and tax free, and supervising a team of traders dedicated to the wealth management transactional, advisory and correspondent businesses. He manages daily trading, risk and marketing activities for all securities that support the firm's clients. Mr. Boardman was named to the RBC Wealth Management Directors Group in 2005, chairs the Wealth Management Fixed Income New Product Review Committee, is a member of the RBC Wealth Management Investment Committee, New Product Review Committee, Structured Product Review Committee, Regulatory Review Committee and is a former chairperson and current member of the Municipal Markets Review Committee. He is also a member of the SIFMA Retail Fixed Income Committee. Mr. Boardman began his career in 1977 after receiving a BA degree from the University of Rochester and subsequently earning his MBA from the Wharton Graduate School of the University of Pennsylvania. He has more than 37 years of industry experience in the fixed income markets, and holds the Series 7, 12, 24, 52, 53 and 63 licenses from FINRA. He has served as manager of trading and sales departments dedicated to the investment needs of both institutional and individual clients. He is involved in many charitable organizations, is an officer and board member of the Lisa B. Fishman Foundation, volunteers his time on behalf of the SIFMA Foundation and is active in many regional youth-oriented community efforts.

**Robert A. Muh** co-founded Sutter Securities Incorporated in 1992 where he is the Chief Executive Officer and the Chief Compliance officer. Sutter is a San Francisco based full service broker-dealer specializing in fixed income products including municipal bonds, institutional private placements primarily for small and medium sized public companies and providing expert testimony in securities related litigation or arbitration. Sutter was recently approved to operate an Alternative Trading System to provide financing for major infrastructure projects. Bob has served on FINRA's Small Firm Advisory Board and the National Arbitration and Mediation Committee. He currently serves as a member of District Committee No.1. From 1978 to June 1987, Mr. Muh was a senior managing director with Bear Stearns & Co. Bob was head of the Bear Stearns Los Angeles corporate finance department until 1984 when he relocated to San Francisco to manage all of the firm's business activities in the Pacific Northwest. Mr. Muh has supervised numerous public offerings and merger assignments. Prior to joining Bear Stearns, Bob was chairman of Newburger, Loeb & Co., Inc. a New York Stock Exchange member firm and a management consultant with McKinsey & Co. in New York. Mr. Muh has a bachelor's degree from the Massachusetts Institute of Technology and both an MBA and a Master of Philosophy degree from Columbia University. While at Columbia, Mr. Muh was an Adjunct Assistant Professor of Finance. Bob is currently an Adjunct Professor at the University of San Francisco Law School where he is on the Advisory Board to the University's Investor Justice Project.

**Paige W. Pierce** brings over 30 years of senior level investment industry experience with small firms and major corporate entities in the North American capital markets to RW Smith. Ms. Pierce has extensive trading and sales, compliance, operational, business and product development, as well as strategic partner development experience both domestically and internationally. In her current position she oversees the growth and strategy of the firm, works closely with industry regulators, and continues to focus on ensuring small firms and their customers have access to information flow, extended distribution networks, price transparency and the wholesale market. She was elected to represent the Small Firm sector of the investment industry, currently over 3700 firms, on the Financial Industry Regulatory Authority's National Adjudicatory Council, which is the appellate court for regulatory actions brought by FINRA against members and member firms within the investment industry, as well as membership application reviews. Ms. Pierce actively serves as a member of the Securities Industry and Financial Markets Association Small Firms Advisory Committee, Municipal Executive Committee, Municipal Broker's Broker Committee (Chair 2008-11 and 2015), and the Emergency Markets & Calendar Committee. In 2008, she was elected to serve a 3-year term on the FINRA District 3 Committee (Chair 2010-11) and currently serves on the FINRA Fixed Income Committee. She serves as hearing panelist for cases brought by or through FINRA and is a frequent speaker at industry events. Ms. Pierce co-founded the Women in the Investment Industry PSA group, is a member of the Utah Chapter of the World Presidents' Organization and previously held both the Network Chair position of the Utah Chapter of the Young Presidents' Organization (2011-13) and the position of Chair of the YPO Pacific Region Women's International Network (2007-09). She is currently on the YPO Advisory Board with Stanford University and has represented the Small Firm sector of the municipal bond market in Municipal and Credit Markets meetings with the Federal Reserve Chairman. In 2008, she was appointed by the United States Air Force 388<sup>th</sup> Fighter Wing as Honorary Commander at Hill Air Force Base in Utah and serves to this day with pride. She is also currently on the Board of Directors for RW Smith, the Municipal Bond Information Services (MBIS) and the National Association of Broker Dealers (NABD).

**Michael L. Post** is General Counsel-Regulatory Affairs of the Municipal Securities Rulemaking Board (MSRB), where he is a legal and policy advisor to the MSRB and its Board of Directors. He manages the development of regulations governing municipal securities dealers and municipal advisors in support of a fair and efficient municipal securities market. Prior to joining the MSRB in 2013 as Deputy General Counsel, Mr. Post served for more than 10 years at the U.S. Securities and Exchange Commission. From 2007 to 2009, he was counsel to former Chairs Christopher Cox and Mary Schapiro, assisting with the development and implementation of an agency-wide regulatory agenda. In that capacity, Mr. Post advised on a broad range of legal, policy and management issues arising primarily out of the Divisions of Trading and Markets and Enforcement as well as the Office of the General Counsel and Office of Municipal Securities. He also assisted with the SEC's response to the financial crisis of 2008. From 2009 until 2013, Mr. Post served as a senior appellate litigator in the SEC Office of the General Counsel, representing the SEC in the Circuit Courts of Appeals and U.S. Supreme Court in matters arising out of rulemakings, enforcement actions and adjudications as well as the SEC's amicus curiae program. He is a recipient of the Manuel F. Cohen Outstanding SEC Younger Lawyer Award from the Securities Law Committee of the Federal Bar Association. Earlier in his career, he was an associate in the Supreme Court and Appellate Litigation Group at Sidley, Austin, Brown & Wood LLP, and a law clerk on the U.S. Court of Appeals for the Tenth Circuit. Mr. Post earned a Bachelor of Arts degree in economics from the University of California, Los Angeles, and a juris doctor, with high honors,

from The George Washington University Law School, where he was a senior editor of the *Law Review*.

**John Reilly** brings 25 years of Capital Markets experience to Wells Fargo Advisors. He has traded repurchase agreements for Wells Fargo Securities, foreign exchange, treasuries and agencies for Wells Fargo Advisors and Managed the Advisory Trading Desk. Most recently as a business leader he is responsible for market risk, trading systems, vendor and dealer relationships, best practices in legal, compliance and regulatory affairs, and represents WFA in Wells Fargo's Volcker Compliance and Metrics Implementation Program. Mr. Reilly also serves on the firms Best Execution, and Balance Sheet & Capital Review Committees. Prior to joining Wells Fargo's legacy firm First Union, in 1996, he has worked with Prudential-Bache, NatWest, BONY's Government Securities Clearance Services, and served in the United States Navy during the Persian Gulf War with distinction, as a Combat Tactical Information Coordinator.



Municipal Securities Rulemaking Board

## **Fixed Income Market Structure: Pre- and Post-Trade Disclosures**

Michael L. Post

General Counsel – Regulatory Affairs

FINRA Fixed Income Conference  
Crowne Plaza Times Square Manhattan Hotel  
March 10, 2015



Municipal Securities Rulemaking Board

## **Proposed Amendments to MSRB Rule G-15**

Pricing Reference Information

## Background on Pricing Reference Information Proposal

- In 2012, the SEC issued a report on the municipal securities market
  - Common themes included concern about transparency and pricing for customers, particularly retail customers
- The report set forth a number of recommendations, including:
  - Encouraging or requiring dealers to provide retail customers relevant pricing reference information with respect to a municipal securities transaction effected by the dealer for a customer
  - Requiring dealers to seek the best-execution of customer orders
  - Requiring dealers to disclose to customers, on confirmations for riskless principal transactions, the amount of any markup

## Summary of Pricing Reference Information Proposal

- Under existing MSRB Rule G-15, dealers must disclose on the confirmation the price of the municipal securities transaction
  - For agency transactions, dealers must also disclose the amount of remuneration received from the customer
  - For principal transactions, dealers are not required to disclose any markup

## Summary of Pricing Reference Information Proposal (*continued*)

- A new provision would be added to MSRB Rule G-15 to require dealers, for retail-size transactions, to disclose on the customer confirmation, in addition to the customer's trade price:
  - Its trade price for a defined "reference transaction;" and
  - The difference in price between the "reference transaction" and the customer trade
- Retail-size Transactions
  - A transaction involving 100 bonds or fewer or bonds in a par amount of \$100,000 or less

## Summary of Pricing Reference Information Proposal (*continued*)

- A reference transaction is a transaction in which the dealer transacts:
  - In a principal capacity;
  - With a third party to purchase or sell municipal securities;
  - In the same security as the customer;
  - On the same side of the transaction as the customer (as purchaser or seller);
  - On the same date as the customer transaction; and
  - Where the size of the dealer transaction(s), in total, would equal or exceed the size of the customer transaction

## Summary of Pricing Reference Information Proposal (*continued*)

- Disclosure requirement would be triggered when the:
  - Dealer is a party on the same side of the transaction as the customer (as purchaser or seller); and
  - The total size of a single trade would equal or exceed the size of the customer transaction or when combined with one or more other same-day reference transactions, equals or exceeds the size of the customer transaction

## Summary of Pricing Reference Information Proposal (*continued*)

- When multiple dealer trades equal or exceed the amount of the customer transaction, many methodologies may be available to determine, which price to disclose on the customer confirmation
- These include:
  - Disclosing the trade that is closest in time proximity to the customer trade;
  - Disclosing the last principal trade that preceded the customer trade a last in, first out, or (LIFO methodology) in the case of a customer purchase, or disclosing the first principal trade that followed the customer trade (a first in, first out, or FIFO methodology) in the case of a customer sale; or
  - Disclosing the weighted average price of multiple trades

## **Fixed Income Market Structure: Pre- and Post-Trade Disclosures**

Michael L. Post  
General Counsel – Regulatory Affairs

FINRA Fixed Income Conference  
Crowne Plaza Times Square Manhattan Hotel  
March 10, 2015

## Pricing Disclosure in the Fixed Income Markets

### FINRA Requests Comment on a Proposed Rule Requiring Confirmation Disclosure of Pricing Information in Fixed Income Securities Transactions

Comment Period Expires: January 20, 2015

#### Executive Summary

FINRA is requesting comment on a proposed FINRA rule that would require firms to disclose additional information on customer confirmations for transactions in fixed income securities. Specifically, FINRA is proposing that, for same-day, retail-size principal transactions, firms disclose on the customer confirmation the price to the customer, the price to the member of a transaction in the same security, and the differential between those two prices. FINRA and the Municipal Securities Rulemaking Board (MSRB) have discussed a coordinated approach to potential rulemaking in this area. The MSRB also is publishing a notice soliciting comment on a similar proposal.

The text of the proposed rules can be found in Attachment A.

Questions concerning this *Notice* should be directed to:

- ▶ Patrick Geraghty, Vice President, Market Regulation, at (240) 386-4973;
- ▶ Cynthia Friedlander, Director, Fixed Income Regulation, Regulatory Operations at (202) 728-8133; or
- ▶ Andrew Madar, Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8056.

November 2014

#### Notice Type

- ▶ Request for Comment

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Senior Management
- ▶ Trading

#### Key Topics

- ▶ Fixed Income Securities
- ▶ Pricing Information
- ▶ Transaction Confirmations

#### Referenced Rules & Notices

- ▶ FINRA Rule 2232
- ▶ SEA Rule 10b-10
- ▶ MSRB Regulatory Notice 2014-20

## Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by January 20, 2015.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to [pubcom@finra.org](mailto:pubcom@finra.org); or
- ▶ Mailing comments in hard copy to:  
Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposal.

**Important Notes:** All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.<sup>1</sup>

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA or Exchange Act).<sup>2</sup>

## Background and Discussion

As part of its oversight of corporate and agency bond transactions, FINRA monitors firms' pricing of transactions based on TRACE reports. FINRA has observed that a significant number of retail-sized transactions (100 bonds or less or bonds with a face value of \$100,000 or less) appear to have offsetting trades by the member firm in very close conjunction. Specifically, using data from the third quarter of 2013 for corporate bonds, FINRA has observed that over 60 percent of retail-size customer trades had corresponding principal trades on the same trading day. In over 88 percent of these events, the principal and the customer trades occurred within thirty minutes of each other. FINRA also has observed that while many of these trades have apparent mark-ups within a close range, significant outliers exist, indicating that customers in those trades paid considerably more than customers in other similar trades.<sup>3</sup> Although knowledgeable industrious customers could observe these trading patterns retrospectively using TRACE data, our understanding is that retail customers do not typically consult TRACE data.<sup>4</sup>

Customer confirmations already disclose the price to the customer of the bond transaction. FINRA believes that customers in retail-size trades would benefit from additional confirmation disclosure of the price of the offsetting trade by the firm and the differential between these prices when the offsetting trade is within the same trading day.

### Recent Developments

In 2012, the Securities and Exchange Commission (SEC) issued a report on the municipal securities market, which surveyed the market structure and disclosure practices of the municipal securities market and made several recommendations including improving pre-trade and post-trade transparency and reinforcing existing dealer obligations.<sup>5</sup> Among other things, the report recommended that the MSRB require municipal bond dealers to disclose to customers on confirmations for riskless principal transactions the amount of any mark-up or mark-down.<sup>6</sup>

In addition, in a speech given on June 20, 2014, SEC Chair Mary Jo White broadly identified initiatives to address investor concerns in the fixed income markets.<sup>7</sup> Among other things, Chair White stated that the SEC would work with FINRA and the MSRB to develop rules regarding the disclosure of mark-ups in “riskless principal” transactions for both corporate and municipal bonds<sup>8</sup> to help customers assess the reasonableness of their dealer’s compensation, as riskless principal transactions become more common in the fixed income markets.<sup>9</sup>

### Proposed Disclosure Requirement

As described in more detail below, FINRA believes that enhancing the disclosure requirements for transactions in fixed income securities to include additional pricing information will benefit investors by providing them with more information to better evaluate their transactions. FINRA is therefore proposing to amend FINRA Rule 2232 to require customer confirmation disclosure of same-day pricing information for customer retail size transactions in corporate and agency debt securities.<sup>10</sup>

Specifically, where a firm executes a sell (buy) transaction of “qualifying size” with a customer and executes a buy (sell) transaction as principal with one or multiple parties in the same security within the same trading day, where the size of the customer transaction(s) would otherwise be satisfied by the size of one or more same-day principal transaction(s), confirmation disclosure to the customer would be required. That disclosure would entail (i) the price to the customer; (ii) the price to the firm of the same-day trade; and (iii) the difference between those two prices.<sup>11</sup> The rule would define “qualifying size” as a purchase or sale transaction of 100 bonds or less or bonds with a face value of \$100,000 or less, based on reported quantity, which is designed to capture those trades that are retail in nature.

The following examples address whether a transaction would trigger the proposed confirmation disclosure requirement:<sup>12</sup>

**Example 1**

- ▶ 10:00:00 AM Firm A purchases 50 XYZ bonds from a dealer at a price of 100 for \$50,000.
- ▶ 10:00:15 AM Firm A sells 50 XYZ bonds to one customer at a price of 102 for \$51,000.

Since the transaction involves the purchase of 50 bonds by the customer within the same trading day as Firm A's purchase of the same number of bonds, Firm A would be required to disclose on the customer confirmation the price to the firm (100), the price to the customer (102) and the differential between the two prices (2).

**Example 2**

- ▶ 10:00:00 AM Firm A purchases 500 XYZ bonds from a dealer at a price of 100 for \$500,000.
- ▶ 10:15:00 AM Firm A sells 100 XYZ bonds to 5 customers at a price of 102.50 for \$102,500 per customer.

Since the transactions involve the purchase of 100 bonds by each customer within the same trading day as Firm A's purchase of the same total number of bonds, Firm A would be required to disclose on the customer confirmations to each of the 5 customers the price to the firm (100), the price to the customer (102.50), and the differential between the two prices (2.50).

**Example 3**

- ▶ 10:00:00 AM Firm A purchases 500 XYZ bonds from a dealer at a price of 100 for \$500,000.
- ▶ 10:15:00 AM Firm A sells 30 XYZ bonds to 1 customer at a price of 102.50 for \$30,750.

Since the size of the customer transaction was satisfied by the size of the firm's principal transaction on the same day, Firm A would be required to disclose on the customer confirmation the price to the firm (100), the price to the customer (102.50), and the differential between the two prices (2.50).

**Example 4**

- ▶ 10:00:00 AM Firm A sells 100 XYZ bonds to a customer at a price of 102 for \$102,000.
- ▶ 10:15:00 AM Firm A buys 500 XYZ bonds from a dealer at a price of 100 for \$500,000.

Since the size of the customer's purchase of bonds from Firm A is satisfied by the size of Firm A's purchase of bonds within the same trading day, Firm A would be required to disclose on the customer confirmation the price to the firm (100), the price to the customer (102), and the differential between the two prices (2.00).

**Example 5**

- ▶ 10:00:00 AM Firm A purchases 500 XYZ bonds from a dealer at a price of 100 for \$500,000.
- ▶ 10:15:00 AM Firm A sells 500 XYZ bonds to a customer at a price of 102.50 for \$512,500.

Firm A would not be required to disclose the proposed pricing information on the customer confirmation because the size of the customer transaction exceeds the qualifying size disclosure threshold of 100 bonds or less.

**Example 6**

- ▶ 10:00:00 AM Firm A purchases 50 XYZ bonds from Customer 1 at a price of 98 for \$49,000.
- ▶ 10:30:00 AM Firm A sells 50 XYZ bonds to Customer 2 at a price of 102 for \$51,000.

Firm A would have disclosure requirements under the proposal to both customers. For Customer 1, Firm A would disclose the price to the firm (102), the price to the customer (98) and the differential between the two prices (4.00). For Customer 2, Firm A would disclose the price to the firm (98), the price to the customer (102) and the differential between the two prices (4.00).

**Example 7**

- ▶ 10:00:00 AM Firm A purchases 40 XYZ bonds from a dealer at a price of 100 for \$40,000.
- ▶ 15:30:00 PM Firm A purchases 60 XYZ bonds from another dealer at a price of 99 for \$59,500.
- ▶ 15:45:00 PM Firm A sells 100 XYZ bonds to 1 customer at a price of 99.70 for \$99,700.

Where multiple firm trades equal the amount of the customer trade, Firm A would be required to disclose on the customer confirmation the weighted average price of the firm trades to the firm (99.40), the price to the customer (99.70), and the differential between the two prices (0.30). Note: In this example, the two firm trades are the equivalent of the customer trade and therefore a weighted average price would be used. Example 9 below provides a scenario where there are multiple transactions as principal that could form the basis of the firm's corresponding transaction(s) with its customers.

**Example 8**

- ▶ 10:00:00 AM Firm A purchases 100 XYZ bonds from a dealer at a price of 100 for \$100,000.
- ▶ 10:15:00 AM Firm A sells 70 XYZ bonds to one customer at a price of 100 for \$70,000.

Firm A would be required to disclose on the customer confirmation the price to the firm (100), the price to the customer (100), and the differential between the two prices (0).

**Example 9**

- ▶ 10:00:00 AM Firm A purchases 200 XYZ bonds from a dealer at a price of 102.50 for \$205,000.
- ▶ 10:30:00 AM Firm A purchases 100 XYZ bonds from a dealer at a price of 104 for \$104,000.
- ▶ 13:30:00 PM Firm A purchases 500 XYZ bonds as part of an institutional trade at a price of 103.50 for \$517,500.
- ▶ 15:00:00 PM Firm A sells 100 XYZ bonds to a customer at a price of 104.50 for \$104,500.

Where the firm engages in multiple transactions as principal that form the basis of its transactions with customers but exceed the number of bonds of the customer trade, FINRA expects that the firm would consistently apply a last in, first out (LIFO) methodology that would refer to the last principal trade(s) that preceded the customer trade. Firm A would therefore be required to disclose on the customer confirmation the price to the firm of the last transaction (103.50), the price to the customer (104.50), and the differential between the two prices (1).

**Example 10**

- ▶ 10:00:00 AM Firm A sells 100 XYZ bonds to a customer at a price of 102 for \$102,000.
- ▶ 10:15:00 AM Firm A buys 500 XYZ bonds from a dealer at a price of 100 for \$500,000.
- ▶ 10:30:00 AM Firm A buys 200 XYZ bonds from a dealer at a price of 101 for \$202,000.

Where the firm engages in multiple transactions as principal that form the basis of its transactions with customers but exceed the number of bonds of the customer trade, FINRA expects that, in this scenario, the firm would consistently apply a methodology that would refer to the principal trade(s) in closest time proximity to the customer trade. Firm A would therefore be required to disclose on the customer confirmation the price to the firm of its first purchase (100), the price to the customer (102), and the differential between the two prices (2).

**Example 11**

- ▶ 15:30:00 PM (Trading Day 1) Firm A purchases 50 XYZ bonds from a dealer at a price of 100 for \$50,000.
- ▶ 10:00:00 AM (Trading Day 2) Firm A purchases 50 XYZ bonds from a dealer at a price of 102.50 for \$51,250.
- ▶ 10:15:00 AM (Trading Day 2) Firm A sells 50 XYZ bonds to 1 customer at a price of 103 for \$51,500.

Since the transaction involved the same-day purchase of 50 bonds by the customer, Firm A would be required to disclose on the customer confirmation the price to the firm (102.50), the price to the customer (103), and the differential between the two prices (0.50). The transaction that occurred on the previous trading day (Trading Day 1) would not be incorporated into the price disclosure.

**Example 12**

- ▶ 15:30:00 PM (Trading Day 1) Firm A purchases 200 XYZ bonds from a dealer at a price of 104 for \$208,000.
- ▶ 10:15:00 AM (Trading Day 2) Firm A sells 100 XYZ bonds to a customer at a price of 106 for \$106,000.

Firm A would not be required to disclose the pricing information on the customer confirmation since Firm A's position was acquired on a previous trading day before it was sold to the customer, and is therefore not subject to the disclosure requirement.

**Example 13**

- ▶ 15:30:00 PM (Trading Day 1) Firm A purchases 50 XYZ bonds from a dealer at a price of 100 for \$50,000.
- ▶ 10:00:00 AM (Trading Day 2) Firm A purchases 50 XYZ bonds from a dealer at a price of 101.50 for \$50,750.
- ▶ 10:15:00 AM (Trading Day 2) Firm A sells 100 XYZ bonds to 1 customer at a price of 102 for \$102,000.

Firm A would not be required to disclose the pricing information on the customer confirmation since the customer order could only be filled by the positions in XYZ that Firm A had acquired over two trading days. The transaction is therefore not subject to the disclosure requirement.

## Economic Impact Analysis

### Need for the Rule

FINRA is concerned that investors in fixed income securities currently are limited in their ability to understand and compare transaction costs.<sup>13</sup> FINRA believes that furnishing additional pricing-related information to customers as part of the customer confirmation will provide customers with meaningful and useful information.

### Economic Baseline

The proposed disclosure will likely affect both broker-dealers and retail investors that engage in transactions in fixed income securities. Under SEC Rule 10b-10 and current FINRA rules, a broker-dealer acting as principal for its own account and trading fixed income securities with a customer is not required to disclose the difference between the price to the customer and the price of the broker-dealer's offsetting trade(s). In the absence of the proposal, customers would not be able to ascertain with certainty the specific price to the broker-dealer in connection with a customer trade.

Retail customers currently receive some of the information considered in this proposal. Specifically, confirmation statements already include the price of bonds purchased. But the confirmation is not required to include information about the cost of the security to the firm. FINRA is aware that some broker-dealers may provide an indication of market value of the bond as part of the confirmation, where that market value reflects either a recent transaction price or a valuation for bonds that have not otherwise traded in close proximity to the customer trade.

As previously noted, FINRA makes TRACE data available to the public, and retail customers may have access to recent trading histories through free finance Web portals, such as Yahoo Finance or FINRA's own website. But it is not possible to determine the value of the specific securities offered to the customer from the public sources.

### Benefits

FINRA believes this additional pricing information will better enable customers to evaluate the cost and quality of the services firms provide by assisting customers in monitoring current same-day prices a firm and a customer pays or receives in connection with a transaction. The proposal will provide customers with pricing information that customers cannot currently obtain through TRACE data. FINRA further believes this type of information will promote transparency into firms' pricing practices and encourage communications between firms and their customers about pricing of their fixed income transactions. This proposal also may provide customers with additional information that may assist them in detecting practices that are possibly improper, which would supplement FINRA's own surveillance and enforcement program.<sup>14</sup>

## Costs

FINRA recognizes that the proposal would impose burdens and costs on firms. Specifically, FINRA expects that the proposal would require firms to modify their systems to identify instances where firm and customer trades in the same security occur on the same trading day and to adopt a methodology to satisfy the disclosure requirement. Firms may need to record and monitor the decisions on the disclosure methodology. Firms would have to adopt compliance policies and procedures to ensure consistent and appropriate application of the methodology. Firms would also be required to calculate the price difference between the customer and firm trade, and to convey the firm price and differential to the customer price on the customer confirmation. FINRA understands some firms may use legacy systems for confirmations which may be costly to reprogram. FINRA staff will estimate the costs based on the information obtained through the public comment process.

FINRA is requesting comment on the potential for the proposal to have an unintended negative impact on market behavior, such as whether the proposal could result in decreased liquidity in the fixed income market, for example, if firms were less likely to hold bonds in inventory, or if firms would reduce service in retail-size trades. Specifically, FINRA is seeking evidence of the likelihood and size of such an impact. FINRA also is soliciting comment on whether the proposal could create confusion for investors where an investor receives the proposed disclosure for some transactions (*e.g.*, below the proposed size threshold and the firm and customer trades occur on the same trading day), but not for other transactions (*e.g.*, above the proposed size threshold or where the firm and customer trades did not occur on the same trading day).

## Regulatory Alternatives

FINRA also recognizes that there are alternatives to the proposed approach of requiring disclosure of pricing information for trades in the same security where the firm and the customer trades occur on the same trading day. For example, another possible approach would be to require disclosure of the same pricing information, but limited to “riskless principal” trades, which would be consistent with the amendments to Rule 10b-10 that were previously proposed by the SEC.<sup>15</sup>

FINRA believes that there are increased benefits to requiring disclosure of pricing information for all trades in the same security where the firm and the customer trades occur on the same trading day, rather than limiting the proposal to only riskless principal trades. For example, FINRA believes using the proposed approach would result in the disclosure of pricing information for more retail-size trades, and that limiting the proposal to riskless principal transactions would exclude transactions where the pricing information would be valuable to the customer.<sup>16</sup> FINRA also believes that, in trades in the same security where the firm and the customer trades occur on the same trading day, most of these trades occur in close time proximity to each other, which minimizes concerns that intervening news or market movement that occur between the component trades would create a corresponding change in the price differential between the components.<sup>17</sup> FINRA believes that the close time proximity of the trades further supports that the pricing information would be valuable to investors.

In addition, FINRA believes that the proposed approach may allow for a more mechanical approach by firms than the riskless principal or marking approaches, which may require firms to conduct a trade-by-trade analysis to determine whether a specific trade was riskless or not. FINRA therefore believes that the proposed approach will provide more certainty to firms regarding their confirmation disclosure obligations. To the extent there are questions as to the methodology a firm uses to determine whether a trade is subject to the disclosure requirement, especially where a firm engages in multiple transactions as principal that form the basis of its corresponding transactions with customers, FINRA is specifically soliciting comment on such question as set forth in the Request for Comments section below.

FINRA also appreciates the potential complexities of requiring confirmation disclosure for trades in the same security where the firm and the customer trades occur on the same trading day, especially from an operational perspective. Another alternative may be to require a firm to disclose on customer confirmations for principal retail-size bond trades the mark-up in the transaction based on a reasonable marking methodology consistently used by the firm in valuing the bonds for internal and other regulatory purposes. For near-time offsetting trades, the marking methodology would presumptively use cost unless a reasonable basis for using another price can be demonstrated. As set forth in the Request for Comments section below, FINRA is specifically soliciting comment on whether an alternative approach would be preferable to the proposed concept.

As set forth above, FINRA recognizes that there are alternative forms and data points of pricing information that may be disclosed to retail customers, and specifically requests comment on such alternatives. Of the options that were considered, however, FINRA believes that, in trades in the same security where the firm and the customer trades occur on the same trading day, requiring firms to disclose the price to the firm, the price to the customer, and the corresponding differential will provide customers with comprehensive and beneficial information, while balancing the costs and burdens to firms of providing the disclosure.

## Request for Comments

FINRA seeks comments on all aspects of the proposal as outlined above. In addition to general comments, FINRA specifically requests comments on the following questions. FINRA requests data and quantified comments where possible.

1. What are the anticipated benefits to investors of providing the proposed disclosure?
  - ▶ Would the proposed disclosures better enable customers to evaluate the cost and quality of the services firms provide, and help ensure customers receive fair and reasonable prices?
  - ▶ Would the proposed disclosures provide investors with greater transparency into the compensation of their brokers or the costs associated with the execution of their fixed income trades?
2. What kinds of costs would this requirement impose on firms, including the anticipated costs to firms in developing and implementing systems to comply with the proposal?
  - ▶ What are the estimates of these costs and what are the assumptions that underlie those estimates? Are the estimates different for firms of different sizes and different business models?
3. In addition to systems modifications, are there other potential changes to firms' infrastructure that would be necessary? What are those modifications?
4. For which transactions should pricing disclosures be made?
  - ▶ Does the proposal address the universe of transactions that should require confirmation disclosure?
  - ▶ Should the proposal be expanded beyond corporate bonds and agency debt to apply to other categories of fixed income securities? If so, why, and if not, why not?
  - ▶ Is it appropriate to only require a dealer to disclose pricing information when the customer trade is a retail trade? If so, should retail be defined by reference to the trade size, as in the proposal, or by some other standard, such as retail customers?
  - ▶ Should the proposal be expanded to require the disclosure of pricing information for transactions where the customer trade is of qualifying size (100 bonds or less or bonds with a face amount of \$100,000 or less), and where the firm trade is for a number of bonds that is less than the customer trade?
  - ▶ Should there be any exclusions for certain types of transactions, notwithstanding the fact that they are retail-sized transactions? For example, should the proposed disclosures not be required for new issue trades?
  - ▶ How would alternatives impact the costs and benefits of the proposal?

5. Are there alternative forms of disclosure or methods to achieve the objectives of the proposal and are they better suited than the proposal?
- ▶ Should the disclosure include the percentage of the price differential or the firm's mark-up or mark-down on the transaction? Would the objectives of the proposal be achieved if a firm was only required to disclose the price paid or received by the firm in its transaction with a third party, and not the corresponding differential?
  - ▶ Should the disclosure include a total dollar amount differential (*i.e.*, a differential that calculates the total dollar amount differential based on the number of bonds purchased or sold by the customer), rather than solely the proposed price differential? What are potential benefits and drawbacks of using such a differential? To illustrate this possible approach, Example 1 above would be revised as follows:
    - 10:00:00 AM Firm A purchases 50 XYZ bonds from a dealer at a price of 100 for \$50,000.
    - 10:00:15 AM Firm A sells 50 XYZ bonds to one customer at a price of 102 for \$51,000.Firm A would be required to disclose on the customer confirmation the price to the firm (100), the price to the customer (102) and the total dollar amount differential between the two trades (\$1,000). The total dollar amount differential is calculated by multiplying the differential between the prices of the firm and the customer trades (2) by the number of bonds in the customer trade (50) by a multiplier of 10.
  - ▶ Rather than using the price to the firm, would the best available representation of current market price be more useful, particularly where the firm-side and customer-side transactions do not occur close in time? If so, given the infrequent trading in many bonds, what would be an acceptable reference price to use to measure the current market price?
  - ▶ As mentioned previously, FINRA could require a firm to disclose on customer confirmations for principal retail-size bond trades the mark-up in the transaction based on a reasonable marking methodology consistently used by the firm in valuing the bonds for internal and other regulatory purposes. For near-time offsetting trades, the marking methodology would presumptively use cost unless a reasonable basis for using another price can be demonstrated.
  - ▶ What would be the costs to firms to implement such an alternative disclosure? What are the assumptions that underlie those cost estimates?

6. To what extent, if any, do firms already provide or make available such information or similar information to customers in any format? Should the proposal allow for alternative methods, if they provide substantially similar pricing information to customers?
7. Should the concept of a “riskless principal” transaction be used in place of the proposed concept, and, if so, can “riskless principal” be defined in a manner that minimizes concerns that market participants would avoid the proposed disclosure requirements?
  - ▶ Would it be feasible to define a riskless principal transaction for purposes of this proposal to include instances where a firm executed a buy or sell order while holding a potentially offsetting “soft” or “firm” order?
  - ▶ Would it be feasible to define a riskless principal transaction to include instances where a firm held inventory for a specified length of time before the customer order was received, or instances where the offsetting trade occurred within 30 minutes of the first trade, assuming the firm was promptly reporting its trades?
  - ▶ What would be the costs to firms to implement such an alternative disclosure? What are the assumptions that underlie those cost estimates?
8. Should disclosure be subject to a *de minimis* standard, *e.g.*, disclosure of a price differential below a specified threshold would not be required? If so, how should the existence of the threshold be communicated to customers so the customers understand that the trades have a differential? How would such a *de minimis* standard impact the costs and benefits associated with the proposal?
9. When a firm executes multiple transactions as principal, which then form the basis of the firm’s corresponding transactions with its customers, is the last in, first out (LIFO) approach the most appropriate methodology to use?
  - ▶ Would it be appropriate to allow firms to have flexibility to establish their own methodology, consistent with the objectives of the proposal, which would be documented by the firm in its written policies and procedures and consistently applied? For example, is it appropriate to allow firms to utilize a reference price that is based on a same-day principal trade that does not meet the LIFO standard, where the size of that principal trade is more equivalent to the size of the customer trade? What other approaches might a firm adopt?
10. When a firm executes a transaction as principal with a customer, such as in Example 6, where the firm buys 50 XYZ bonds from one customer and then sells 50 XYZ bonds to another customer, FINRA understands that the price paid to the customer may not represent the firm’s true price of the trade, *e.g.*, it may reflect a mark-down. For purposes of the proposed disclosure requirement, should firms be allowed to use a different price as the reference price in this scenario, assuming the firm is able to justify and document its decision?

11. Are there other potential effects to markets and market participants of the proposal?
- ▶ Would the proposal alter the incentives and dynamics of the broker-customer relationship, cause firms to reduce service in retail-sized trades, or encourage firms to trade with customers as principal from inventory?
  - ▶ Would applying the proposal to a limited set of securities on a pilot basis provide useful information, including whether firm behavior would change as a result of the disclosure requirement?
  - ▶ How should FINRA measure and assess these potential effects against the benefits the proposal might create?
12. Would it be appropriate or beneficial for firms to supplement the proposed disclosures by providing customers with an explanation of the pricing information or to provide customers with additional information relevant to execution quality? If so, what kind of documentation would be appropriate for this purpose? Should this practice be permitted or required?

## Endnotes

1. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.
2. *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.
3. *See* note 16 *infra*.
4. *See* note 13 *infra*.
5. *See* U.S. Securities and Exchange Commission, Report on the Municipal Securities Market, dated July 31, 2012.
6. As noted above, the MSRB is publishing a similar proposal regarding disclosure of information by dealers to their retail customers to help them independently assess the prices they are receiving from dealers and to better understand some of the factors associated with the costs of their transactions. The MSRB's proposal also broadly seeks input on alternative regulatory approaches, including mark-up and mark-down disclosure on confirmations for trades that could be considered riskless principal transactions.  
  
A mark-down is the amount by which the price of a security is reduced from the prevailing market price. A mark-up is the amount in excess of the prevailing market price that a customer pays a dealer when purchasing a security.

7. See speech by Chair White, dated June 20, 2014, *Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors*, Economic Club of New York, New York, NY.
8. MSRB Rule G-15 governs customer confirmations for transactions in municipal securities.
9. SEC Rule 10b-10 governs confirmations that must be delivered to customers in connection with transactions in equity and fixed income securities, except municipal securities. That rule generally requires that a broker-dealer acting in an agency capacity disclose the amount of any remuneration received or to be received from its customer in connection with a transaction in equity or fixed income securities. See 17 CFR 240.10b-10(a)(2)(i). When a broker-dealer is acting as principal, however, the disclosure requirements related to pricing information are different for equity and fixed income securities. When a broker-dealer is acting in a riskless principal capacity, Rule 10b-10 only requires a broker-dealer to disclose the amount of its mark-up or mark-down for transactions in equity securities. See 17 CFR 240.10b-10(a)(2)(ii). As a result, a customer receives different pricing information on its transaction confirmation depending on the type of security it is buying or selling.  
  
FINRA rules also require that firms send transaction confirmations to customers, but do not impose any additional disclosure requirements on firms related to pricing information beyond what is required under SEC Rule 10b-10. Rule 2232 requires that a member send a customer confirmation before or upon completion of a transaction for or with a customer, in accordance with the requirements of SEC Rule 10b-10. See Rule 2232(a). In addition, FINRA rules governing mark-ups and mark-downs set forth standards by which the amount of a mark-up or mark-down may be assessed, but do not require members to disclose the amount of the mark-up or mark-down. See Rule 2121.
10. The rule defines a “corporate debt security” as a debt security that is United States (U.S.) dollar-denominated and issued by a U.S. or foreign private issuer and, if a “restricted security” as defined in Securities Act Rule 144(a)(3), sold pursuant to Securities Act Rule 144A, but does not include a Money Market Instrument as defined in Rule 6710(o). An “agency debt security” shall have the same meaning as in Rule 6710(l). The proposal would not apply to transactions in asset-backed securities, as defined in Rule 6710(m).
11. As indicated previously, under Rule 10b-10, firms are already required to disclose on confirmations the price of the security that was bought or sold by the customer.
12. Each of the following examples assumes a par value of \$1,000 per bond. The disclosure requirements for bonds with a par value greater than \$1,000 may vary, based on the number of bonds traded.
13. Currently, customers may use TRACE to determine pricing information for a fixed income security that is eligible for TRACE reporting, including the last trade price, execution time and execution quantity, using either the issuer’s name or the CUSIP number. While this information may provide the customer with a useful basis of comparison for its transaction, a customer would not be able to use TRACE data to ascertain with certainty the specific price to its broker-dealer in connection with its trade, or the actual amount of the mark-up or mark-down incurred in connection with its trade.

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In addition, investors would need to possess a certain degree of knowledge and skill to access and derive relevant information from TRACE. Therefore, existing TRACE data alone may not assist customers in fully understanding their trading costs.

14. See Securities Exchange Act Release No. 33743 (March 9, 1994), 59 FR 12767 (March 17, 1994) (noting the functions of the transaction confirmation).
15. See Securities Exchange Act Release No. 33743 (March 9, 1994), 59 FR 12767 (March 17, 1994). For purposes of requiring disclosure in equity securities where a broker or dealer is acting as principal for its own account, Rule 10b-10 requires disclosure where a broker or dealer, “after having received an order to buy from a customer . . . purchased the equity security from another person to offset a contemporaneous sale to such customer or, after having received an order to sell from a customer, the broker or dealer sold the security to another person to offset a contemporaneous purchase from such customer.” See 17 CFR 240.10b-10(a)(2)(ii).
16. Using TRACE data from 3Q13, FINRA has observed that the proposed approach would have resulted in 41 percent more retail-size trades receiving pricing information. FINRA has also observed that, using TRACE data from 2013, the price differentials for customer buy and sell orders (which can be an indicator of the firm’s mark-up and mark-down practices), were of varying amounts within similar sized trades, and that varying price differentials were not limited to riskless principal trades. FINRA therefore believes that the disclosure of pricing information should apply to a wider range of customer transactions, and should not be limited to riskless principal trades.

For example, for transactions of 10 to 40 bonds (or 10,000 to 40,000 par amount) in the Investment Grade category, the median calculated differential on customer sell orders was .42 percent, but the 95th percentile was 1.49 percent and the 99th percentile was 2.29 percent. For transactions of 40 to 70 bonds (or 40,000 par amount to 70,000 par amount) in the Investment Grade category, the median calculated differential was .38 percent, but the 95th percentile was 1.49 percent and the 99th percentile was 2.29 percent.

Similarly, with respect to the calculated differential on customer buy orders, for transactions of 10 to 40 bonds (or 10,000 to 40,000 par amount) in the Investment Grade category, the median calculated differential on customer buy orders was .66 percent, but the 95th percentile was 2.15 percent and the 99th percentile was 2.71 percent. For transactions of 40 to 70 bonds (or 40,000 to 70,000 par amount) in the Investment Grade category, the median calculated differential was .63 percent, but the 95th percentile was 2.08 percent and the 99th percentile was 2.76 percent.

This difference was also present in high yield and unrated securities.

17. TRACE data from 3Q13 also indicated that approximately 95 percent of the same-day trades occurred within 30 minutes of each other.

## ATTACHMENT A

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

### FINRA Rules

#### 2230. Customer Account Statements and Confirmations

#### 2232. Customer Confirmations

(a) A member shall, at or before the completion of any transaction in any security effected for or with an account of a customer, give or send to such customer written notification (“confirmation”) in conformity with the requirements of SEA Rule 10b-10.

(b) A confirmation given or sent pursuant to this Rule shall further disclose:

(1) with respect to any transaction in any NMS stock, as defined in Rule 600 of SEC Regulation NMS, or any security subject to the reporting requirements of the FINRA Rule 6600 Series, other than direct participation programs as defined in FINRA Rule 6420, the settlement date of the transaction; [and]

(2) with respect to any transaction in a callable equity security, that:

(A) the security is a callable equity security; and

(B) a customer may contact the member for more information concerning the security[.]; and

(3) with respect to a sale to (purchase from) a customer of Qualifying Size involving a corporate or agency debt security, where the member also executes a buy (sell) transaction(s) as principal with one or multiple parties in the same security within the same trading day where the size of the principal transaction(s) executed on the same trading day would meet or exceed the size of the customer transaction:

(A) the price to the member;

(B) the price to the customer; and

(C) the differential between the two prices in (A) and (B).

(c) Definitions

For purposes of this Rule, the term:

(1) “corporate debt security” shall mean a debt security that is United States (“U.S.”) dollar-denominated and issued by a U.S. or foreign private issuer and, if a “restricted security” as defined in Securities Act Rule 144(a)(3), sold pursuant to Securities Act Rule 144A, but does not include a Money Market Instrument as defined in Rule 6710(o) or an Asset-Backed Security as defined in Rule 6710(m);

(2) “agency debt security” shall have the same meaning as in Rule 6710(l); and

(3) “Qualifying Size” shall mean a transaction for the purchase or sale of 100 bonds or less or bonds with a face amount of \$100,000 or less, based on reported quantity.

\* \* \* \* \*

## Fixed Income Quotation Information and Alternative Trading Systems

### FINRA Requests Comment on Proposal to Require Alternative Trading Systems to Submit Quotation Information Relating to Fixed Income Securities to FINRA for Regulatory Purposes

Comment Period Expires: April 7, 2015

#### Executive Summary

FINRA is soliciting comment on a proposal to require alternative trading systems (ATs) to submit quotation information relating to corporate and agency debt securities to FINRA solely for regulatory purposes. The proposed rule text is attached as Appendix A.

Questions regarding this *Notice* should be directed to:

- ▶ Patrick Geraghty, Vice President, Quality of Markets, at (240) 386-4973;
- ▶ Ola Persson, Vice President, Transparency Services (TS), at (212) 858-4796;
- ▶ Elliot Levine, Associate Vice President and Counsel, TS, at (202) 728-8405;
- ▶ Lisa Horrigan, Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8190; or
- ▶ Alex Ellenberg, Assistant General Counsel, OGC, at (202) 728-8152.

February 2015

#### Notice Type

- ▶ Request for Comment

#### Suggested Routing

- ▶ Compliance
- ▶ Fixed Income
- ▶ Legal
- ▶ Operations
- ▶ Systems
- ▶ Trading
- ▶ Training

#### Key Topics

- ▶ Alternative Trading Systems
- ▶ Fixed Income
- ▶ Quotation Information

#### Referenced Rules

- ▶ FINRA Rule 0150
- ▶ FINRA Rule 5220
- ▶ FINRA Rule 5310
- ▶ FINRA Rule 6710
- ▶ Securities Act Rule 144A
- ▶ SEC Rule 300

## Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by April 7, 2015.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to [pubcom@finra.org](mailto:pubcom@finra.org); or
- ▶ Mailing comments in hard copy to:

Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposal.

**Important Notes:** All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.<sup>1</sup>

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA or Exchange Act).<sup>2</sup>

## Background and Discussion

Electronic markets for fixed income instruments are growing. This expansion of electronic markets includes the use of alternative trading systems for retail size bond orders. Currently, FINRA member firms are not required to routinely make available quotation information for fixed income securities for either regulatory or dissemination purposes. As a result, unlike the listed equities markets where FINRA receives consolidated information on quotations and trades, FINRA does not have ongoing access to quotation information for fixed income securities.

To inform FINRA's regulation of and strengthen its ability to surveil fixed income trading, FINRA is requesting comment on a proposal to require ATs to submit to FINRA for regulatory purposes quotation information for corporate and agency debt securities.

Under the proposal, fixed income quotation information reported to FINRA would not be publicly disseminated and would be used solely for regulatory and surveillance purposes.

## Scope of the Proposed Reporting Requirement

The proposed reporting requirement would apply only to ATSs that display quotations in fixed income securities. FINRA recognizes that there are other significant electronic fixed income trading platforms that are not ATSs; however, it believes that initially limiting the proposed reporting requirement to ATSs is a clear, measured step that will capture useful data, particularly for retail size trades, that will be informative both for surveillance purposes and for purposes of analysis of the potential value and feasibility of public dissemination in the future. A broader proposal that would include, for example, request for quote (RFQ) platforms that are not ATSs, do not carry actionable quotes, and service more of the institutional and inter-dealer market may potentially be more complex and burdensome for firms from a reporting standpoint.

Under the proposal, ATSs would be required to provide FINRA with quotation information only for TRACE-eligible corporate and agency debt securities.<sup>3</sup> ATSs would not be required to provide quotation information for other fixed income products such as securitized products (*e.g.*, mortgage- and asset-backed securities).<sup>4</sup> An ATS would be required to report all quotation information that it displays to its general subscriber base or a subset of its subscriber base, including all updates to such quotations, made on a real-time or other basis. For purposes of the proposed reporting requirement, “quotation” includes both “subject” (*i.e.*, the price is subject to confirmation) and firm<sup>5</sup> quotes (including those identified as eligible for automatic execution) and thus would be defined generally as any offer to buy from or sell to any person or entity at a specified price, yield or spread, including any priced orders that may be displayed on behalf of a customer.<sup>6</sup> An ATS that conducts an RFQ business would not be required to report quotation information resulting from the RFQ process, where the quote provided is intended only for the requesting party and not a broader set of subscribers.

The specific quotation information that an ATS would need to report under the proposal would include the identity of the party submitting the quote (or an indication that the submitting party is a non-member) and the party’s capacity (*i.e.*, agent or principal, if capacity information is conveyed to the ATS); the CUSIP or FINRA symbol of the quoted security; the date, time, and duration (if applicable) of the quote; the actual or minimum size associated with the quote; the price, yield, or spread to benchmark (including information on the relevant benchmark) of the quote as it was submitted by the party to the ATS; the quote as displayed to the ATS subscribers, whether the quote was “subject” or firm; the side of the quotation (buy or sell); and whether the quote was modified or cancelled, and if so, the date and time of the modification or cancellation.

ATSs would need to report this quotation information to FINRA on a weekly basis. Accordingly, an ATS would be required to report by the end of week 2 all quotation information for the prior week 1. Because the data will be provided to FINRA for regulatory and post-trade date surveillance purposes only, FINRA does not believe that real-time reporting is warranted under the current proposal.

Finally, in connection with this *Regulatory Notice* comment process, FINRA may determine to request that ATSS provide a limited amount of historical quotation information (*e.g.*, for a specified period of months or a designated quarter) on a one-time basis, to help inform the rulemaking process (*e.g.*, by identifying additional data elements to be reported).

## Economic Impacts

### Anticipated Benefits

The proposed reporting requirement would strengthen FINRA's overall regulation, and particularly its automated surveillance of fixed income trading by providing additional information on prevailing market conditions. FINRA may detect compliance violations and potentially manipulative behaviors in fixed income instruments more effectively with the assistance of the quotation data. The proposed reporting requirement would also enable FINRA to study the data submitted by ATSS to assess the existing information available to ATS subscribers and to more fully explore the implications of the differences between the fixed income and equity markets.

### Anticipated Costs

FINRA recognizes that the proposed reporting requirement would require ATSS to establish a process (*e.g.*, file transfer protocol) through which to submit quotation information to FINRA. Thus, ATSS would potentially be subject to a one-time development cost, as well as ongoing costs for operational support and monitoring for compliance (*i.e.*, to ensure that the submissions meet the requirements under FINRA rules). FINRA anticipates leveraging its existing infrastructures for the transmission of data to FINRA to minimize the impact and costs on firms and FINRA. FINRA encourages commenters to provide estimates of the potential costs associated with the proposed reporting requirement. FINRA also requests comments on the proposal's potential indirect impact on liquidity and market participation.

## Request for Comment

FINRA requests comment on all aspects of the proposed reporting requirement, including any impact on investors, fixed income trading platforms, or market makers. In addition, FINRA specifically requests comment on the following issues:

- ▶ Do commenters believe the scope of the proposed reporting requirement is appropriate?
  - ▶ Should FINRA consider broadening the reporting requirement to collect quotation information from other fixed income trading mechanisms, such as RFQ platforms? If so, what other entities should be included, and why, and how should such quotation information be collected?

- ▶ FINRA understands that some quotations displayed through an ATS may not be displayed to all subscribers, but only to a subset of the general subscriber base. How common is that practice? How are those sub-groups determined?
- ▶ FINRA is proposing to initially require quotation information for corporate bond and agency debt securities. Should the scope of the proposed reporting requirement be expanded to include securitized products? To what extent would an expansion of the reporting requirement to all TRACE-eligible securities impact an ATS's compliance costs?
- ▶ Would the proposed reporting requirement potentially have unintended consequences, such as on a fixed income trading platform's willingness to commence and continue operating as an ATS? Similarly, would the exclusion of RFQs from the scope of the proposal impact firms' quoting behavior?
- ▶ What would be the potential costs to ATSs of the proposed reporting requirement?
  - ▶ How many ATSs would be subject to the proposed reporting requirement?
  - ▶ Would there be a one-time development cost to build a reporting mechanism? If so, how much would it be?
  - ▶ In addition to potentially incurring a one-time development cost to build a reporting mechanism, what ongoing costs may an ATS incur, *e.g.*, for operational support, monitoring and compliance? How much would the costs be?
  - ▶ Would the costs be different for ATSs with different sizes or business models?
  - ▶ Are there any alternative approaches that FINRA should consider that may lessen compliance costs?
- ▶ In what form do ATSs maintain quotation information today, and for what period of time? Is the information that ATSs would be required to report for each quotation currently maintained in an automated format? If not, what systems changes would be required to compile and report the information? What would be the associated costs?
- ▶ As noted above, FINRA is proposing to require ATSs to report one week's quotation information by the end of the following week. Would ATSs want the option of submitting quotation information on a real-time or near real-time (*e.g.*, end of day or next day) basis rather than weekly batch submissions?
- ▶ To what extent would a requirement to report quotation information to FINRA more frequently than each week, for example on a real-time basis or next-day basis, affect a firm's costs to comply?
- ▶ ATSs would report to FINRA, among other things, the identity and capacity of the party that submitted the quote to the ATS if it is a FINRA member firm or an indicator, but not the specific identity, when the submitting party is a non-FINRA member firm. Are there any challenges with identifying these elements for reporting purposes? Is there any additional information that should be collected concerning identity or capacity?

FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible.

## Endnotes

1. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
2. *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.
3. The terms “TRACE-Eligible Security” and “agency debt security” are defined in FINRA Rule 6710(a) and (l), respectively. The term “corporate debt security” would be defined in proposed Rule 45XX(a)(3).
4. The term “securitized product” is defined in FINRA Rule 6710(m) (effective April 27, 2015).
5. FINRA Rule 5220 generally prohibits members from making an offer to buy from or sell to any person any security at a stated price unless such member is prepared to purchase or sell, as the case may be, at such price and under such conditions as are stated at the time of such offer to buy or sell. The Supplementary Material further provides that under normal circumstances where the member is making a “firm trading market” in any security, it is expected at least to buy or sell a normal unit of trading in the quoted stock at its then prevailing quotations unless it is clearly designated as not firm or firm for less than a normal unit of trading when supplied by the member.  
  
FINRA notes further that nothing in this proposal, including discussion of whether quotations are “subject” or firm, is intended to inform or otherwise impact the SEC’s definition of the term “order” in SEA Rule 3b-16 or SEC Regulation ATS.
6. Quotations or expressions of interest that do not communicate a specified price would not be covered by this proposal.

## APPENDIX A

Below is the text of the proposed rule change. Proposed new language is underlined.

### 4000. FINANCIAL AND OPERATIONAL RULES

\* \* \* \* \*

### 4500. BOOKS, RECORDS AND REPORTS

\* \* \* \* \*

### 4550. ATS Reporting

\* \* \* \* \*

### 45XX. Requirements for Alternative Trading Systems to Submit Quotation Information for Fixed Income Securities

(a) Within seven business days after the end of each week, each member that has a Form ATS on file with the SEC shall report to FINRA solely for regulatory purposes, in such format as FINRA may require, Quotation Information displayed by the ATS to its general subscriber base, or a subgroup of its general subscriber base, during the previous week for the following securities:

- (1) corporate debt securities; and
- (2) agency debt securities.

(b) Definitions

For purposes of this Rule, the term:

- (1) “agency debt security” has the same meaning as in Rule 6710(l);
- (2) “ATS” has the same meaning as the term “alternative trading system” as defined in Rule 300 of SEC Regulation ATS;
- (3) “corporate debt security” means a debt security that is United States (“U.S.”) dollar-denominated and issued by a U.S. or foreign private issuer and, if a “restricted security” as defined in Securities Act Rule 144(a)(3), sold pursuant to Securities Act Rule 144A, but does not include a Money Market Instrument as defined in Rule 6710(o);
- (4) “quotation” means any offer to buy from or sell to any person or entity at a

specified price, yield, or spread, including any priced orders that may be displayed on behalf of a customer, and includes both “subject,” i.e., the price is subject to confirmation, and firm quotes, including those identified as eligible for automatic execution.

(5) “Quotation Information” shall include for each quotation:

(A) the party submitting the quotation (or an indication that the submitting party is a non-member) and the party’s capacity (i.e., agent or principal, if capacity information is conveyed to the ATS);

(B) the CUSIP number or FINRA symbol of the quoted security;

(C) the date, time, and duration (if applicable) of the quotation;

(D) the actual or minimum size associated with the quotation;

(E) the price, yield, or spread to benchmark, including information on the relevant benchmark, of the quotation as it was submitted by the party to the ATS;

(F) the quotation as displayed to ATS subscribers;

(G) whether the quotation was “subject” or firm;

(H) the side of the quotation (buy/sell); and

(I) whether the quotation was modified or cancelled and if so, the date and time of the modification or cancellation.

**••• Supplementary Material: -----**

.01 For purposes of compliance with this Rule, each member that has a Form ATS on file with the SEC must report Quotation Information as it was provided to the ATS by the subscriber and as it was displayed by the ATS (e.g., a calculated price where the subscriber submitted a spread and inclusive of any fees added by the ATS). Quotation Information does not include the “request for quote” process, where the quote provided is intended only for the requesting party and not a broader set of subscribers.

\* \* \* \* \*