



VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

January 20, 2015

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

Re: Regulatory Notice 14-52: Pricing Disclosure in the Fixed Income Markets

Dear Ms. Asquith:

On November 17, 2014, the Financial Industry Regulatory Authority (FINRA) published its request for public comment on proposed recommendations to require additional pricing disclosure on customer confirmations for retail fixed income transactions (Proposed Rule).¹ The Proposed Rule requires broker-dealers to include on customer confirmations for retail size fixed income transactions: (i) the price to the customer; (ii) the price to the firm of the same-day principal trade; and (iii) the difference between those two prices. The Proposed Rule would only apply in circumstances where the firm has executed a same-day principal transaction offsetting the customer's transaction. FINRA stated that it believes increasing pricing disclosure for fixed income transactions will allow investors to better evaluate the costs and quality of services provided.

The Financial Services Institute (FSI)² appreciates the opportunity to comment on this important proposal. FSI welcomes regulatory initiatives to help improve investor education and disclosure in the fixed income markets. As such, we support the principle that retail investors should have access to timely and complete information to make informed investment decisions. FSI is also supportive of increasing pricing transparency in the secondary fixed income markets. However, FSI is concerned that the Proposed Rule may not strike an appropriate balance between potential benefits to investors and potential costs such as operational difficulties, detrimental market impacts, and increased customer confusion. FSI requests that FINRA consider several suggested alternatives in light of these concerns.

¹ Regulatory Notice 14-52, Pricing Disclosure in the Fixed Income Markets (Nov. 2014) available at, <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p601685.pdf>.

² The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives. These financial advisors are self-employed independent contractors, rather than employees of Independent Broker-Dealers (IBD).

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations and retirement plans with financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their investment goals.

Discussion

FSI appreciates the opportunity to comment on the Proposed Rule. We support efforts to increase price transparency and investor education. However, we have several concerns with the proposed approach to achieve these goals. The Proposed Rule presents significant operational difficulties, creates the potential for unintended consequences, and risks confusing investors. As such, FSI proposes several alternatives that achieve a balance between costs and benefits, leverage existing investor education resources, and ensure customers receive access to increased information concerning the execution of their fixed income transactions. These concerns and potential alternatives are discussed in greater detail below.

I. Unintended Consequences

A. Imprudent Investment Decisions

FSI believes that it is important to consider a variety of factors in evaluating the execution quality of a fixed income transaction. Placing a disproportionate emphasis on price may not best serve investors. Customer transactions are currently subject to suitability,³ fair pricing⁴ and best execution requirements.⁵ Each of these rules serves a vital investor protection purpose and together ensure that customers receive fair prices for investments that are appropriate to their financial condition and investment needs. As such, it is unclear why pricing disclosure on a confirmation is necessary to protect investors. If each of these three requirements has been satisfactorily met in the opinion of regulators, it is unclear to FSI why there should be an implication that customers are being excessively charged for fixed income transactions. Furthermore, if FINRA has evidence of excessive mark-ups, the execution quality mandates should provide adequate authority to address these situations.

³ See FINRA Rule 2111.

⁴ See FINRA Rule 2121.

⁵ See FINRA Rule 5310.

Furthermore, FSI cautions that instructing investors to use this additional disclosure to search for the financial firm that offers the lowest mark-ups is misguided and potentially not in investors' best interest. Pricing information absent context may be confusing and inaccurate. Customers need contextual explanations to understand why they were charged for the transaction and why these services are necessary to effect their investment decisions. Additionally, customers should receive education that ensures they are making investment decisions consistent with their needs and objectives. While pricing may be a factor that aids such an analysis it is certainly not the only one and, perhaps, not even the most important one. Rather, it is important to encourage investors to seek out the financial advisor that best understands their investment needs and has the requisite expertise. Encouraging investors to seek out the broker-dealer offering the lowest price may not be consistent with investor protection goals.

B. Flight to Packaged Products

The additional disclosures imposed by the Proposed Rule may have the unintended consequence of limiting investor access to individual fixed income products. As a result of the increased compliance burden imposed by the Proposed Rule firms may steer investors interested in a fixed return toward packaged products, to the detriment of investors. Individual fixed income securities offer greater transparency concerning the anticipated return as compared to packaged products. In a rising interest rate environment an investment with a stated maturity may be a more appropriate investment for customers. FSI suggests FINRA consider amending the Proposed Rule to create a proposal that is neutral in the face of changing economic conditions.

C. Negative Impact on Liquidity

The Proposed Rule may also have a detrimental impact on liquidity in the secondary fixed income markets. Mandating additional disclosures might disincentivize participants from engaging in retail-size transactions.⁶ This potentiality is all the more significant in light of the negative impact that enhanced capital rules and other regulatory requirements have had on bond market liquidity.⁷ A further erosion of liquidity in the bond markets may significantly inhibit FSI members' ability to adequately service their customers. The secondary debt markets are innately opaque. Oftentimes, trading for a particular CUSIP could require significant time and effort on the part of the broker-dealer. Ensuring the existence of as many market participants as possible is critical to aiding broker-dealers in their efforts to facilitate transactions in illiquid securities for their customers. Furthermore, there are currently other regulatory requirements that can be used to ensure that the actions of a firm in fixed income trading for customers are fair and reasonable. As such, FSI does not believe that the benefits of the Proposed Rule are outweighed by these potential negative market impacts.

D. Eroding Yield

FSI also suggests FINRA consider the potential that securities industry participants may convert customer brokerage accounts to fee-based advisory accounts, to avoid the Proposed

⁶ Proposed FINRA Rule 2232(c)(3) defines "qualifying size" as "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. FINRA stated that this captures transactions that are "retail in nature." See Regulatory Notice 14-52, *supra* note 1.

⁷ Tom Braithwaite and Vivianne Rodrigues, *Banks Blame Bond Volatility on Tighter Regulation*, Financial Times (Oct. 16, 2014), available at <http://www.ft.com/cms/s/0/1a456bc6-54d9-11e4-bac2-00144feab7de.html#axzz3NxcBff5Y>.

Rule's disclosure obligations. These unintended activities may harm the integrity of the secondary fixed income markets and harm investors. Advisory accounts would avoid the additional disclosure requirements consistent with prior SEC No-Action Letters. While the advisors would maintain a fiduciary duty to the customers, maintaining debt securities, particularly those with low yields in an advisory account will inappropriately erode that already small yield. FSI requests FINRA consider this potentiality and act accordingly to ensure that investors do not suffer the consequences of eroding yield.

II. Customer Confusion

A. Purpose and Use of Confirmation

Prior to pursuing the Proposed Rule, FSI suggests that FINRA poll investors to understand how, and to what extent, they use trade confirmations. The SEC has previously stated that customer confirmations serve "basic investor protection functions by conveying information allowing investors to verify the terms of their transactions; alerting investors to potential conflicts of interest with their broker-dealers; and providing investors the means to evaluate the costs of their transactions and the quality of their broker-dealer's execution."⁸ The SEC further acknowledged that a firm may use a confirmation as a customer invoice while it finances positions when payment is received after settlement date. Additionally, confirmations may simply serve as "written evidence of a contract between the customer and broker-dealer," consistent with Uniform Commercial Code requirements. FSI believes it is worthwhile for FINRA to understand whether investors and firms use confirmations consistent with the SEC's stated intent for their issuance.

It is important for FINRA to ensure that any effort to increase pricing transparency and investor education is undertaken in a manner that will in fact achieve these goals. Online and mobile access to account holdings and transaction information is an important and widely used tool. Through online viewing of their accounts investors may review all of the information that is included on a confirmation. Additionally the information is available to investors sooner than a confirmation is delivered. In light of these new and innovative ways for investors to interact with their brokerage accounts, FSI suggests FINRA evaluate the impact of further technological development on the purpose and use of customer confirmations.

B. Solicitation of Feedback from Investor Focus Groups

FSI also suggests that FINRA consider the potential for customer confusion and the desire for increased information at the time of trade. Currently, customers receive a significant amount of information and disclosures from their financial advisors. Increasing the amount of information on the disclosure may not be the best method for educating customers on the pricing of their fixed income transactions. Confirmations already contain a significant amount of information, some transaction-specific and some generic disclosures. Supplying a customer with a document containing too much information may cause the customer, already the recipient of multiple documents, disclosures and prospectuses to ignore the additional pricing information included on a confirmation. Furthermore, supplying additional pricing information without any explanation of methodology behind such pricing may create additional customer confusion.

⁸ Confirmation of Transactions, SEC Release 34-34962, 59 Fed. Reg. 59612, 59613 (Nov. 17, 1994).

In an effort to ensure that industry and regulatory resources are channeled efficiently FSI suggests FINRA undertake investor surveys and focus groups to learn from investors exactly what information they are interested in and the particular method in which they would like to receive it. While FSI members agree with FINRA's intention to further educate investors on the nuances of fixed income markets, we ask that FINRA first ensure that its Proposed Rule is in fact desired by investors. FSI stands willing to work with FINRA to increase investor understanding of market operations and functions in a way that will capture investors' attention. The significant operational and system implications associated with adding this pricing information to a confirmation suggests that it would be appropriate for FINRA to evaluate whether the Proposed Rule is truly in line with investor desires.

III. Operational Implications

A. System Modifications

The additional disclosures mandated by the Proposed Rule will require substantial modifications and upgrades to current trading and back-office systems. Many FSI member firms are fully-disclosed introducing brokers that execute their customer transactions through their clearing firm or through other executing brokers. Alternatively, FSI members may execute their customers' transactions while relying on a clearing firm for clearing and custodial services, including sending confirmations. In either case, all of these firms will be required to work with their clearing firms and other third-party providers to modify their interfaces to ensure that not only the customer trade but also the appropriate reference transaction is captured and transmitted to the clearing firm. Additionally, FSI member firms will be required to work with these providers to create oversight mechanisms to ensure that the correct information is included on the confirmations. In the event a mistake is printed and sent to a customer, FSI members will be required to work with these providers to amend and resend the confirmation.⁹

These enhancements necessitate the establishment of additional processes that are both automated and manual in nature. Particularly for smaller firms without the requisite resources to build and maintain fully automated systems, the Proposed Rule will require the creation of multiple additional manual processes. The manual nature of these additions presents a high level of operational risk such that these smaller firms may no longer be able to offer fixed income products to their customers. Firms will be required to hire additional personnel to track and log both customer and same-day reference transactions, input and transmit each pair of transactions along with the price differential to the clearing firm for inclusion on the confirmation and review customer confirmations to validate the accuracy of the information provided to the customer. These additional processes create multiple opportunities for errors that will result in increased costs for firms to correct, inaccurate information provided to customers and increased customer confusion following the receipt of multiple confirmations for a particular transaction.

FSI requests that FINRA strongly consider the impacts of these necessary system enhancements in evaluating the costs and benefits of the Proposed Rule. The Securities and Exchange Commission has previously acknowledged the importance of considering these practical implications in evaluating the merits of additional confirmation disclosure:

⁹ FSI also requests FINRA detail whether there will be a penalty imposed on firms that send amended confirmations due to an error in the original confirmation. There is a high potential for errors due to the manual nature of new systems. FSI does not believe firms should be penalized when there were good faith efforts to comply with a rule.

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

FSI requests that FINRA undertake a similar analysis of the impact of the Proposed Rule and determine if the benefits outweigh these increased costs.

B. Implementation Period

Should FINRA proceed with the Proposed Rule, FSI suggests that it provide a minimum of a 12 month implementation period in light of the significant technological and operational enhancements the proposal demands. Broker-dealers are currently engaged in many significant technological initiatives. These include the Consolidated Audit Trail and potentially the Comprehensive Automated Risk Data System. The same personnel that are necessary to build systems to comply with these regulatory mandates will also be responsible for system enhancements to comply with additional pricing disclosures. Each of these initiatives is labor intensive. Some FSI members worked with their providers to estimate that the Proposed Rule could require a minimum of five thousand hours to build the necessary system enhancements. In an effort to provide the industry with adequate time to comply with the Proposed Rule and the bevy of additional technological initiatives currently underway, FSI requests FINRA adopt a 12 month implementation period.

IV. **Alternative Disclosure Options**

A. Leveraging TRACE

FSI suggests FINRA undertake an analysis of potential enhancements to promotion efforts to retail investors regarding TRACE and the pricing information it offers. Currently, investors may view pricing information including last trade price, execution time, execution quantity, and the nature of the transaction on TRACE. As such, TRACE provides a significant amount of the information that would be provided to customers pursuant to the Proposed Rule. In light of the amount of time and resources expended to build and continually develop TRACE, FSI asks FINRA to consider initiatives to greater publicize to investors how they can use TRACE to find relevant pricing information.

For example, FINRA could consider establishing a separate TRACE website that would be linked on the FINRA homepage. Establishing a separate website would ensure that customers can more easily access TRACE and are better aware of this important market data tool. To further facilitate customer use of TRACE, FSI suggests FINRA seek public comment on a proposal to mandate the inclusion of a statement on the confirmation directing customers to the TRACE website to view pricing information. For electronically delivered confirmations, the statement could also include a hyperlink to the TRACE website. Alternatively, we recommend FINRA consider exploring additional options that would require broker-dealers to direct investors to TRACE to view pricing information. In concert, these small additions could significantly raise the profile of TRACE such that retail investors would consult TRACE data more frequently. Hopefully, investors will eventually

¹⁰ SEC Release 34-33743, 59 Fed. Reg. 12767, 12772 (Mar. 17, 1994).

consult this data prior to executing a transaction. Consulting pricing data at the time they are making their investment decisions will better serve customers than after-the-fact disclosure.

B. Broker-Dealer Websites

A second potential alternative would be to require pricing disclosure on broker-dealer websites. The disclosures would be made directly to a customer that is logged in and viewing their personal account holding. Alternatively, FINRA could mandate broker-dealers provide a link to TRACE so customers can access TRACE information on the CUSIPS held in their accounts. FSI suggests FINRA explore opportunities to provide increased pricing information to customers on firm websites. Investors are increasingly accessing account information through online and mobile means. FSI believes that it is vitally important for FINRA to consider this behavior in selecting the best method for providing increased disclosures. Password protected customer pages on broker-dealer websites may be the best place to provide disclosures and educate customers on pricing information.

C. Fixed Income Market Education

FSI also suggests FINRA consider requirements to increase customer knowledge of the operations of the secondary fixed income markets. FSI believes that regardless of whether customers receive specific pricing information it is important for them to understand how prices for fixed income securities are determined. It is not clear that investors currently appreciate the degree of opacity present in fixed income markets. Educating investors on the roles that broker-dealers play in executing fixed income transactions and the steps that must be undertaken to fairly and reasonably fill a customer order are as essential as pricing information.

These educational materials could be required to be delivered to an investor prior to the first execution of a fixed income transaction with that particular financial advisor. Additionally, the disclosure materials could be included on broker-dealer websites so customers can continue to access them. Furthermore, FSI suggests that FINRA pursue additional customer education on the operations of secondary fixed income markets, such as mandating a generic disclosure on confirmations directing customers to consult the disclosure documents available on the broker-dealer's website.

Alternatively, FINRA could require firms to disclose on confirmations the potential existence of a mark-up/mark-down and a point of contact at the firm a client could contact with questions about fixed income pricing. Such a disclosure could read: "On principal fixed income transactions, there may a mark-up/mark-down built into the purchase/sale price. Please contact [Insert Name and Contact Information Here] if you would like additional information about pricing." This disclosure would educate investors about the basics of fixed income pricing, would be relatively easy to understand, and would not present firms with significant operational challenges.¹¹ Should a customer desire to better understand fixed income pricing, this disclosure would direct them to a point of contact that could provide the customer with more detailed information about the firm's pricing schedule and fixed income market structure generally.

¹¹ A disclosure of this sort would be consistent with disclosure requirements for payment for order flow pursuant to Rule 10b-10(a)(2)(i)(C).

D. Centralized Marketplace

FSI also suggests that FINRA commit to exploring ways to establish centralized marketplaces for fixed income securities. True pricing transparency will only be established once the structures of the fixed income markets are altered. Market participants and regulators have recently addressed the possibility of facilitating increased electronic and on-exchange trading of fixed income securities.¹² These proposals recognize the significant difficulties posed by the inherent nuances of fixed income markets. However, they represent first steps in addressing a systemically important issue. Centralized marketplaces would reduce transaction costs, increase transparency and efficiency, and facilitate greater investor protection. FSI believes FINRA should engage the industry, the public and other regulatory authorities in developing a proposal to develop a centralized marketplace and introduce true price transparency. Centralized marketplaces are all the more important if market makers and broker-dealers decrease the extent of their involvement in fixed income markets. Investors may suffer unintended consequences that will result in higher transaction costs and increased inefficiency.

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with FINRA on this and other important regulatory efforts

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. T. Bellaire". The signature is fluid and cursive, with a large initial "D" and "T" and a stylized "Bellaire".

David T. Bellaire, Esq.
Executive Vice President & General Counsel

¹² See e.g. Remarks of Commissioner Daniel Gallagher, Sept. 16, 2014, available at http://www.sec.gov/News/Speech/Detail/Speech/1370542966151#.VKRQrivF_ws; BlackRock, *Corporate Bond Market Structure: The Time for Reform is Now* (Sept. 2014), available at <http://www.blackrock.com/corporate/en-ae/literature/whitepaper/viewpoint-corporate-bond-market-structure-september-2014.pdf>.