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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No.* SR - 2016 - * 032
Amendment No. (req. for Amendments *)

Filing by Financial Industry Regulatory Authority

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * ☑ Amendment * ☐ Withdrawal ☐

Section 19(b)(2) * ☑ Section 19(b)(3)(A) * ☐ Section 19(b)(3)(B) * ☐

Pilot ☐

Extension of Time Period for Commission Action * ☐

Date Expires *

Rule
- ☐ 19b-4(f)(1)
- ☐ 19b-4(f)(2)
- ☐ 19b-4(f)(3)
- ☐ 19b-4(f)(4)
- ☐ 19b-4(f)(5)
- ☐ 19b-4(f)(6)

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Section 806(e)(1) * ☐ Section 806(e)(2) * ☐

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934

Section 3C(b)(2) * ☐

Exhibit 2 Sent As Paper Document ☐ Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed Rule Change Relating to FINRA Rule 2232 (Customer Confirmations) to Require Members to Disclose Additional Pricing Information on Retail Customer Confirmations Relating to Transactions in Fixed Income Securities

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * Andrew Last Name * Madar

Title * Associate General Counsel

E-mail * andrew.madar@finra.org

Telephone * (202) 728-8056 Fax (202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 08/12/2016

By Stephanie M. Dumont

(Name *)

(Title *)

Senior Vice President and Director of Capital Markets Policy

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Stephanie Dumont,

Required fields are shown with yellow backgrounds and asterisks.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information *

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO] -xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO] -xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "SEA"),[1] Financial Industry Regulatory Authority, Inc. ("FINRA") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to amend FINRA Rule 2232 (Customer Confirmations) to require members to disclose additional pricing information on retail customer confirmations relating to transactions in fixed income securities.

The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

At its meeting on February 26, 2016, the FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change no later than 90 days following Commission approval. The effective date will be no later than 365 days following Commission approval.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

FINRA is proposing to amend Rule 2232 to require members to provide additional pricing information on customer confirmations in connection with non-

[1] 15 U.S.C. 78s(b)(1).

municipal fixed income transactions with retail customers. Specifically, if a member trades as principal with a non-institutional customer in a corporate debt or agency debt security, the member must disclose the member's mark-up or mark-down from the prevailing market price for the security on the customer confirmation, if the member also executes one or more offsetting principal transaction(s) on the same trading day on the same side as the customer trade, the aggregate size of which meets or exceeds the size of the customer trade.

While members are already required, pursuant to SEA Rule 10b-10, to provide customers with pricing information, including transaction cost information, in connection with transactions in equity securities where the member acted as principal, no comparable requirement currently exists for transactions in fixed income securities.[2] Based on statistics that are discussed in greater detail below, FINRA believes that some customers pay materially higher mark-ups or mark-downs in retail-size trades than other customers for the same fixed income security. FINRA believes that the proposed requirement will provide meaningful and useful pricing information to retail customers in fixed income securities. FINRA believes that the proposal will better enable customers to evaluate the cost and quality of the execution service that members provide, will promote

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[2] See 17 CFR 240.10b-10. Under Rule 10b-10, where a member is acting as principal for its own account and is not a market maker in an equity security, and receives a customer order in that equity security that it executes by means of a principal trade to offset the contemporaneous trade with the customer, the rule requires the member to disclose the difference between the price to the customer and the dealer's contemporaneous purchase (for customer purchases) or sale price (for customer sales). See Rule 10b-10(a)(2)(ii)(A). Where the firm acts as principal for any other transaction in an NMS stock, or an equity security that is listed on a national securities exchange and is subject to last sale reporting, the rule requires the member to report the reported trade price, the price to the customer in the transaction, and the difference, if any, between the reported trade price and the price to the customer. See Rule 10b-10(a)(2)(ii)(B).

transparency into firms' pricing practices, and will encourage communications between firms and their customers about the pricing of their fixed income transactions.

As described in greater detail in Item 5 below, FINRA initially solicited comment on a related proposal in Regulatory Notice 14-52 ("initial proposal"),[3] and subsequently on a revised proposal in Regulatory Notice 15-36 ("revised proposal").[4] FINRA also has been working with the MSRB to develop similar proposals, as appropriate, to ensure consistent disclosures to customers across debt securities and to reduce the operational burdens for firms that trade multiple fixed income securities. As such, the MSRB has been developing its own pricing information disclosure proposal, and FINRA and the MSRB published their initial and revised proposals concurrently.[5] FINRA understands that the MSRB intends to file a substantially similar rule change.

Provided below is a more detailed description of each aspect of the proposed rule change.

Scope of the Disclosure Requirement

The proposed rule applies where the member buys (or sells) a security on a principal basis from (or to) a non-institutional customer and engages in one or more offsetting principal trades on the same trading day in the same security, where the size of the member's offsetting principal trade(s), in the aggregate, equals or exceeds the size of the customer trade. A non-institutional customer is a customer account that is not an

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3 See Regulatory Notice 14-52 (November 2014).

4 See Regulatory Notice 15-36 (October 2015).

5 See MSRB Regulatory Notice 2015-16 (September 2015), MSRB Regulatory Notice 2014-20 (November 2014).

institutional account, as defined in Rule 4512(c).[6] In addition, the proposed rule applies only to transactions in corporate debt securities, as defined in the proposed rule,[7] and agency debt securities, as defined in Rule 6710(l).[8]

FINRA believes that the proposed rule provides meaningful pricing information to individual investors that would most benefit from such disclosure, while not imposing unduly burdensome disclosure requirements on members. FINRA believes that requiring disclosure for retail customers, i.e., accounts that are not institutional accounts, is appropriate because retail customers typically have less ready access to market and pricing information than institutional customers. FINRA believes that using the definition of an institutional account as set forth in Rule 4512(c) to define the scope of

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6 Rule 4512(c) defines an institutional account as an account of "(1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million."

7 The proposed 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) or an Asset-Backed Security as defined in Rule 6710(cc)."

8 Rule 6710(l) defines an agency debt security as "a debt security (i) issued or guaranteed by an Agency as defined in paragraph (k); or (ii) issued or guaranteed by a Government-Sponsored Enterprise as defined in paragraph (n). The term excludes a U.S. Treasury Security as defined in paragraph (p) and a Securitized Product as defined in paragraph (m), where an Agency or a Government-Sponsored Enterprise is the Securitizer as defined in paragraph (s) (or similar person), or the guarantor of the Securitized Product." To make the proposed changes to Rule 2232 applicable to agency debt securities, as part of this proposal, FINRA will amend Rule 0150 to add Rule 2232 to the list of FINRA rules that apply to "exempted securities," except municipal securities.

the proposal is appropriate because firms use this definition in other rule contexts, therefore reducing the implementation costs associated with this proposal.[9]

Same Day Triggering Timeframe

FINRA believes that it is appropriate to require disclosure of the mark-up or mark-down where the firm's offsetting principal trade(s) equaled or exceeded the size of the customer trade on the same trading day. To the extent that a member will often use its contemporaneous cost or proceeds, e.g., the price it paid or received for the bond, as the prevailing market price for purposes of calculating the mark-up or mark-down, FINRA believes that limiting the disclosure to those instances where there is an offsetting trade in the same trading day will reduce the variability of the mark-up and mark-down calculation.

As is discussed in greater detail in Item 5, a number of commenters stated that the window for triggering disclosure should be limited to two hours. Among other things, commenters argued that a two-hour window would be easier to implement, and would more closely capture riskless principal trades, which would align the proposed disclosure to the riskless principal disclosure requirements for equity securities under Rule 10b-10.

As is also discussed below, FINRA has generated statistics, based on trade data reported to the Trade Reporting and Compliance Engine ("TRACE"), that indicate that

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[9] As discussed in greater detail below, FINRA initially proposed that the disclosure requirement would apply to customer trades of a "qualifying size," which was defined as customer transactions involving 100 bonds or less or bonds with a face amount of $100,000 or less, based on reported quantity. In response to comments that the proposed size-based standard could either exclude retail customer transactions above that amount from the proposed disclosure, or subject institutional transactions below that amount to the proposed disclosure, FINRA revised the proposal to incorporate the Rule 4512(c) definition of an institutional account.

the majority of firm principal/customer trades that occur within the same trading day occur within thirty minutes of one another. Nonetheless, FINRA believes that there are added benefits to requiring disclosure for trades that occur within the same trading day, rather than only trades that occur within two hours. First, the full-day window will ensure that more investors receive mark-up or mark-down disclosure, even where their trades occur more than two hours from the firm principal trade (but still occur on the same trading day). Second, the full-day window may make members less likely to alter their trading patterns in response to the proposed rule, as members would be required to hold positions overnight to avoid the proposed disclosure.[10] Finally, as is discussed further below, TRACE data for 3Q15 shows a material difference between the median mark-up/mark-down and the mark-ups/mark-downs at the tail of the distribution, indicating that some customers (those at the tail of the distribution) paid considerably more than others (at the median of the distribution). This data indicates that there is variability in the difference in prices paid in both firm principal and customer trades that occurred close in time to one another, e.g., within 30 minutes, and in firm principal and customer trades that did not occur close in time to one another. Based on this data,

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[10] It is important to note that, under Rule 5310 (Best Execution and Interpositioning), members must use reasonable diligence to ascertain the best market for the security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. Supplementary Material .01 to Rule 5310 further emphasizes that a member must make every effort to execute a marketable customer order that it receives fully and promptly. Any intentional delay of a customer execution to avoid the proposed rule or otherwise would be contrary to these duties to customers. If the proposed rule change is approved, FINRA will monitor trading patterns to ensure firms are not purposely delaying a customer execution to avoid the disclosure. A firm found to purposefully delay the execution of a customer order to avoid the proposed disclosure may be in violation of the proposed rule, Rule 5310 and Rule 2010 (Standards of Commercial Honor and Principles of Trade).

FINRA believes that the proposed disclosure would provide valuable information for customers whose trades occurred on the same trading day as the firm principal trade, regardless of whether those trades occurred close in time.

Some commenters recommended that FINRA limit the disclosure obligation to riskless principal transactions involving retail investors, as this would more accurately reflect dealer compensation and transaction costs, and would be more consistent with the stated objectives of the SEC in this area. These commenters would apply the proposed rule to riskless principal transactions as previously defined in the equity context by the Commission, where the broker-dealer has an "order in hand" at the time of execution. However, FINRA believes that it may be difficult to objectively define, implement and monitor a riskless principal trigger standard for fixed income securities and also believes that using the riskless principal standard ultimately is too narrow and that customers will benefit from the disclosure irrespective of whether the firm's capacity on the transaction was riskless principal.

Non-Arms-Length Affiliate Transactions

With respect to the offsetting principal trade(s), where a member buys from, or sells to, certain affiliates, the proposal would require the member to "look through" the member's transaction with the affiliate to the affiliate's transaction with a third party in determining when the security was acquired and whether the "same trading day" requirement has been triggered. Specifically, FINRA proposes to require members to apply the "look through" where a member's transaction with its affiliate was not at arms-length. For purposes of the proposed rule change, an "arms-length transaction" would be considered a transaction that was conducted through a competitive process in which non-

affiliate firms could also participate—e.g., pricing sought from multiple firms, or the posting of multiple bids and offers—and where the affiliate relationship did not influence the price paid or proceeds received by the member. As a general matter, FINRA would expect that the competitive process used in an "arms-length" transaction, e.g., the request for pricing or platform for posting bids and offers, is one in which non-affiliates have frequently participated. FINRA believes that sourcing liquidity through a non-arms-length transaction with an affiliate is functionally equivalent to selling out of its own inventory for purposes of the proposed disclosure trigger. FINRA therefore believes it is appropriate in those circumstances to require a member to "look through" its transaction with its affiliate to the affiliate's transaction with a third party to determine whether the proposed rule applies in these circumstances.[11]

Exceptions for Functionally Separate Trading Desks and Fixed-Price Offerings

The proposed rule also contains two exceptions from the proposed disclosure requirement. First, if the offsetting same day firm principal trade was executed by a trading desk that is functionally separate from the firm's trading desk that executed the transaction with the customer, the principal trade by that separate trading desk would not trigger the disclosure requirement. Firms must have in place policies and procedures reasonably designed to ensure that the functionally separate principal trading desk through which the member purchase or member sale was executed had no knowledge of

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[11] Similarly, in a non-arms-length transaction with an affiliate, the member also would be required to "look-through" to the affiliate's transaction with a third party and related cost or proceeds by the affiliate as the basis for determining the member's calculation of the mark-up or mark-down pursuant to Rule 2121 (Fair Prices and Commissions).

the customer transaction.[12] FINRA believes that this exception is appropriate because it recognizes the operational cost and complexity that may result in requiring a firm principal trade executed by a separate, unrelated trading desk as the basis for determining whether a mark-up or mark-down disclosure is triggered on the customer confirmation. For example, the exception would allow an institutional desk within a firm to service an institutional customer without necessarily triggering the disclosure requirement for an unrelated trade performed by a separate retail desk within the firm. At the same time, in requiring that the member have policies and procedures in place that are reasonably designed to ensure that the functionally separate principal trading desk had no knowledge of the customer transaction, FINRA believes that the exception is sufficiently rigorous to minimize concerns about the potential misuse of the exception. In other words, in the example above, the firm could not use the functionally separate trading desk exception to avoid the proposed disclosure requirement if trades at the institutional desk were used to source transactions at the retail desk.

FINRA also believes that this exception is appropriate and consistent with the concept of functional and legal separation that exists in connection with other regulatory requirements, such as SEC Regulation SHO, and notes that some members already maintain functionally separate trading desks to comply with these requirements.

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12 This exception is distinguished from the "look through" provision noted above, whereby the customer transaction is being sourced through a non-arms-length transaction with the affiliate. Under the separate trading desk exception, functionally separate trading desks are required to have policies and procedures in place that are reasonably designed to ensure that trades on the functionally separate desks are executed with no knowledge of each other and reflect unrelated trading decisions. Additionally, FINRA notes that this exception would only apply to determine whether or not the proposed disclosure requirement has been triggered; it does not change a member's existing requirements relating to the calculation of its mark-up or mark-down under Rule 2121.

Second, the proposed rule would not apply if the member acquired the security in a fixed-price offering and sold the security to non-institutional customers at the same fixed-price offering price on the day the securities were acquired. In a fixed-price offering, the compensation paid to the firm, such as the underwriting fee, is paid for by the issuer and described in the prospectus. Given the availability of information in connection with a fixed-price offering, FINRA believes that the proposed disclosure is not warranted in those instances where the security is sold at the fixed-price offering price.

Proposed Information to be Disclosed on the Customer Confirmation

If the transaction meets the criteria described above, the member would be required to disclose the member's mark-up or mark-down from the prevailing market price for the security. The mark-up or mark-down would be calculated in compliance with Rule 2121 and the supplementary material thereunder, and would be expressed both as a total dollar amount and as a percentage of the prevailing market price.[13] FINRA believes that it is appropriate to require firms to calculate the mark-up in compliance with Rule 2121, as Supplementary Material .02 to Rule 2121 provides extensive guidance on how to calculate the mark-up for the fixed income securities to which the proposal would

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13 FINRA and the MSRB conducted investor testing which indicated that investors found that disclosing the mark-up or mark-down both as a dollar amount and as a percentage of the prevailing market price would be more useful than only disclosing it in one of those forms.

FINRA and the MSRB also solicited comment on whether to require members to disclose additional information on the trade confirmation for trades with retail customers, including whether firms should provide a link to TRACE, and whether firms should disclose the time of the customer trade. In response to comments received and support based on investor testing, FINRA intends to submit a rule filing in the near future that proposes these requirements.

apply, including a presumption to use contemporaneous cost or proceeds. While some commenters noted the operational cost and complexity of implementing a previous iteration of this proposal, FINRA notes that firms are currently subject to Rule 2121 and are required to evaluate the mark-ups that they charge in connection with trades to ensure that they are fair and not excessive.[14] FINRA notes that the proposal does not alter the requirements of Rule 2121, or otherwise intend to modify how firms calculate mark-ups. FINRA recognizes that the determination of the prevailing market price of a particular security may not be identical across firms and FINRA will expect that firms have reasonable policies and procedures in place to calculate the prevailing market price and that such policies and procedures are applied consistently across customers. Although the Supplementary Material to Rule 2121 provides extensive guidance, to the extent that firms have additional interpretive questions on the application of Rule 2121 to specific scenarios, FINRA will issue additional guidance as necessary.

FINRA believes that the proposal will provide retail customers with several important benefits. As discussed above, members are not required to provide customers who buy or sell fixed income securities with the same pricing information regarding mark-ups and mark-downs as customers who buy or sell equity securities. FINRA

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[14] Because the proposed mark-up disclosure is not triggered unless an offsetting principal trade occurred on the same day, FINRA anticipates that the number of customer trades that will use a price other than the price of a contemporaneous trade as the prevailing market price are small. Using 3Q15 data, of the retail-size customer trades that have an offsetting firm principal trade on the same trading day, over 83 percent of those trades occurred within 30 minutes of each other. In 10.5 percent of these instances, an intervening trade, either by the same firm or a different market participant, occurred. Given the close time proximity between the majority of firm principal and customer trades, and the fact that most of these trades did not have an intervening trade, firms will typically use their contemporaneous cost as the prevailing market price.

believes that requiring mark-up/mark-down disclosure will provide retail investors in non-municipal fixed income securities in transactions covered by the rule with comparable information to what retail investors in equity securities currently receive. FINRA believes that this disclosure will better assist fixed income investors in understanding and comparing the transaction costs associated with their purchases and sales.

As noted in Item 2 of this filing, if the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change no later than 90 days following Commission approval. The effective date will be no later than 365 days following Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[15] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, and Section 15A(b)(9) of the Act,[16] which requires that FINRA rules not impose any burden on competition that is not necessary or appropriate.

FINRA believes that this proposed rule change is consistent with the Act because it will provide retail customers with meaningful and useful additional pricing information that retail customers cannot readily obtain through existing data sources such as TRACE. This belief is supported by investor testing, which indicates that investors find aspects of

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15 15 U.S.C. 78o-3(b)(6).

16 15 U.S.C. 78o-3(b)(9).

the proposed requirements useful, including disclosing the mark-up or mark-down both as a dollar amount and as a percentage of the prevailing market price. FINRA believes that some customers pay materially more for trades in fixed income securities than other customers in comparable trades. FINRA believes that the proposed rule will better enable customers to evaluate the cost of the services that members provide by helping customers understand mark-ups or mark-downs from the prevailing market prices in specific transactions. FINRA further believes that this type of information will promote transparency into members' pricing practices and encourage communications between members and their customers about the execution of their fixed income transactions. This proposal also will 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.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed changes will apply equally to all similarly situated members. Additionally, all members already have an obligation to calculate mark-ups to ensure compliance with Rule 2121.

Economic Impact Assessment

(a) Need for the Rule

FINRA is concerned that retail investors in fixed income securities currently are limited in their ability to understand and compare transaction costs associated with their purchases and sales. Investor testing conducted by FINRA and the MSRB reveals that

investors lack a clear understanding of the concepts and definitions of mark-up and mark-down and their role in dealer compensation. The proposed disclosure is expected to provide retail investors with valuable pricing information, encourage investor participation in the fixed income markets, and foster price competition among dealers, which may lower transaction costs for retail transactions in fixed income securities.

The staff's analysis of TRACE data for 3Q15 finds a large difference between the estimated median mark-up/mark-down and the tail of the distribution, indicating that some customers paid considerably more than others in similar trades.[17] For example, for retail-size (100 or fewer bonds) investment grade corporate debt transactions in 3Q15, the median estimated mark-up on customer buy orders was 0.53 percent, whereas the 95th percentile was more than four times higher (2.23 percent), suggesting that while the mark-up was half a percent or less on 50 percent of these orders, five percent of the orders (representing approximately 7,000 trades) had mark-ups of more than two percent.[18] Similarly, the median estimated mark-up for retail-size corporate debt

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[17] The mark-up and mark-down calculations involved matching customer trades to offsetting same-day principal trades by the same dealer in the same CUSIP. This included matching same-sized trades as well as trades of different sizes where there was no same-sized match (e.g., a dealer purchase of 100 corporate bonds matched to two sales to customers of 50 corporate bonds each). The mark-ups (mark-downs) on customer buys (sells) correspond to the percentage difference in price in customer trades and the offsetting principal trade. In cases when the offsetting principal trade was also a customer trade, the combined mark-up and mark-down ("spread") on these roundtrip transactions was calculated as the percentage difference in price between the customer buy and the customer sell.

[18] Most matched trades occurred close in time to each other. For example, among mark-up pairs of retail-size customer purchases in investment grade corporate bonds in 3Q15, approximately 80 percent of the paired trades occurred within 30 seconds of each other. Nonetheless, the estimated mark-ups and mark-downs were calculated based on matching customer trades to offsetting same-day principal trades by the same dealer in the same CUSIP, and thus may be different from the ones calculated based on the prevailing market price.

transactions in high-yield and unrated securities in 3Q15 was 0.83 percent and the 95th percentile was 2.96 percent.

Some market participants suggested that the proposed disclosure might not be meaningful because the observed dispersion in mark-ups might be explained by bond- or execution-specific characteristics. The staff's analysis of TRACE data for 3Q15 does not find relationships between mark-ups and bond- or execution-specific characteristics that would fundamentally undermine the value of the proposed requirement.

Specifically, some market participants asserted that high mark-ups might be adequate compensation for enhanced execution price. For example, it was argued that a dealer might reasonably charge a high mark-up on a customer purchase if the transaction price was lower than the prevailing market price. To examine the relationship between mark-up and price, the staff compared the price of each retail-size customer purchase (sale) of a bond to all prices of retail-size customer purchases (sales) of the same bond in 3Q15 to measure relative execution price.[19] The analysis finds that higher estimated mark-ups were associated with higher, not lower, purchase prices as compared to all the purchase prices of the same bond in the same quarter. For instance, for retail-size customer purchases of investment grade corporate bonds, the trades with the lowest estimated mark-ups (below the fifth percentile) had an average price percentile ranking of

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[19] The sample only includes customer transactions that can be matched with offsetting same-day principal trades. In addition, the staff notes that the metric of relative execution price would be less reliable if fixed income security prices fluctuated widely within 3Q15. However, the monthly volatility of 10-year Treasury rates in 3Q15 was always below the average level of the prior 10 years, indicating that the interest rate volatility was moderate during the quarter. Treasury securities are considered to be free of default risk, and therefore are commonly used as a reliable interest rate benchmark for a wide range of private market transactions.

35. In contrast, the trades with the highest estimated mark-ups (above the 95th percentile) had an average price percentile ranking of 63.

Some market participants asserted that high mark-ups and mark-downs might be caused by exceptionally low transaction quantities. For example, it was argued that a high mark-up on a customer purchase order of only three bonds might be justified by the high search cost. The analysis of TRACE data for 3Q15 finds no evidence that the highest estimated mark-ups were associated with unusually low quantities. For instance, for retail-size customer purchases of investment grade corporate bonds, the median quantity of the trades with the highest estimated mark-ups (above the 95th percentile) was 20 bonds. Moreover, the median quantity did not change much for trades with different estimated mark-up levels.[20]

As discussed above, the mark-up and mark-down estimation involves matching same-sized trades as well as trades of different sizes where there was no same-sized match (e.g., a dealer purchase of 100 corporate bonds matched to two sales to customers of 50 corporate bonds each). Some market participants asserted that the practice of breaking down a large transaction into smaller offsetting customer trades might lead to lower mark-ups due to the economies of scale, and thus might help explain the observed dispersion in mark-ups. The analysis of TRACE data for 3Q15 finds that splitting a larger principal trade into multiple smaller offsetting customer trades was associated with higher, not lower, mark-ups.

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[20] The median quantity was 28 bonds for trades with mark-ups below the fifth percentile, 15 bonds for trades with mark-ups between the 25th and 50th percentiles, and 20 bonds for trades with mark-ups between the fifth and 10th percentiles, the 10th and 25th percentiles, the 50th and 75th percentiles, the 75th and 90th percentiles, and the 90th and 95th percentiles.

The analysis of TRACE data for 3Q15 also shows that the observed differences in estimated mark-ups were unlikely to be solely driven by bond characteristics. The results for retail-size customer purchases of investment grade corporate bonds serve as an example. Among the bonds that had the highest estimated mark-ups (above the 95th percentile), approximately 77 percent also had trades with estimated mark-ups below the median. Moreover, these 77 percent of bonds traded more frequently with estimated below-median mark-ups. Further, the staff's analysis finds that bonds with higher trading frequencies in 3Q15, and presumably higher liquidity, had higher estimated mark-ups.[21]

In conclusion, the observed large dispersion in mark-ups and mark-downs do not appear to principally reflect bond or execution characteristics. The proposed disclosure is expected to provide customers with valuable and consistent information to understand, compare and evaluate transaction costs associated with their trades.

(b) Economic Baseline

The proposal would impact broker-dealers in the retail market of corporate and agency debt securities by imposing confirmation disclosure requirements on certain customer transactions. In 3Q15, the average daily number of retail-size customer trades was 18,330 in corporate debt securities and 676 in agency debt securities. The transactions were mainly concentrated among large firms. For example, the top 20 broker-dealers with the highest volumes accounted for roughly 70 percent of the transactions for both corporate and agency debt securities.

It is estimated that approximately 59 percent of the retail-size customer trades in corporate debt securities in 3Q15 would have been subject to the disclosure requirement

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[21] The analysis also finds a negative but limited impact of credit rating on the level of mark-ups.

if the proposed rule had been in place.[22] These disclosure-eligible trades were reported by about 800 dealers but were concentrated among large dealers. As discussed above, dealers already have an obligation to calculate their mark-ups for principal transactions in non-municipal fixed income securities to ensure compliance with Rule 2121.

(c) Economic Impacts

(i) Benefits

FINRA believes that the proposal will provide retail customers with meaningful and useful pricing information that these customers cannot readily obtain through TRACE data. As evidenced by investor testing, investors consider it important to know how much firms charge for transactions in fixed income securities, yet they are unfamiliar with mark-ups and mark-downs. FINRA believes that the pricing information will better enable customers to evaluate the cost and quality of the services that members provide by helping customers understand mark-ups or mark-downs from the prevailing market prices in specific transactions. FINRA further believes that this type of information will promote transparency into members' pricing practices and encourage communications between members and their customers about the pricing of their fixed income transactions. By providing additional pricing information to customers, this proposal may encourage customers to seek out other dealers that might offer more competitive prices for the services offered, which may incentivize members to offer more competitive prices to their retail customers. Any resulting reduction in the differential between the prevailing market price and the price paid by the customer would reduce transaction costs paid by investors and enhance investor confidence in the alignment

[22] The percentage of eligible transactions may be overestimated as some matched trades may be transactions with affiliates or other trading desks.

between transaction costs and the value of the services received, which may encourage wider participation by investors in the retail segments of the corporate and agency debt market.[23]

(ii) Costs

FINRA recognizes that the proposal would impose burdens and costs on members. In both Regulatory Notices 14-52 and 15-36, FINRA specifically solicited comment on the potential costs of the proposal to members.[24] For example, in Regulatory Notice 15-36, FINRA asked about the anticipated costs to firms in developing and implementing systems to comply with the revised proposal and the anticipated on-going costs associated with the revised proposal. FINRA asked members to provide the estimates of these costs, and the assumptions underlying those estimates. While commenters stated that the initial and the revised proposals would impose significant implementation costs on firms, no commenters provided specific cost estimates or a framework to assess anticipated costs.

Among other things, the proposal would require members to develop and deploy a methodology to satisfy the disclosure requirement, identify trades subject to the disclosure, convey the mark-up on the customer confirmation, and adopt policies and procedures to track and ensure compliance with the requirement. To apply the "look

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23 FINRA notes that this proposal may also provide regulatory benefits, as disclosing additional pricing information to customers may assist them in detecting practices that are possibly improper, which would supplement FINRA's own surveillance and enforcement program.

24 Regulatory Notices 14-52 and 15-36 proposed to require members to disclose a "reference price," while this proposal requires mark-up disclosure, as determined from the prevailing market price. As discussed below, requiring mark-up disclosure rather than reference price disclosure may result in lower compliance costs.

through" to non-arms-length transactions with affiliates, members would also need to obtain the price paid or proceeds received and the time of the affiliate's trade with the third party. FINRA is also aware, however, that some members already provide a form of mark-up disclosure for their customers, and may therefore incur fewer costs in complying with the proposed disclosure requirement.

The proposal would require firms to examine transactions occurring both before and after a customer trade execution to determine whether the trade is subject to the disclosure requirement. FINRA recognizes that the forward-looking approach (comparison to trades occurring after customer trades) may be difficult to implement in some current confirmation processing systems. Some firms with such systems stated that they would need to both maintain the current systems and build entirely new systems to comply with the proposed rule change. The operational impact of the proposal would be more material to these firms.

(iii) Effect on Competition

FINRA believes that the proposal would improve price transparency, enhance investor confidence, and promote price competition among dealers in the retail market of corporate and agency debt securities. Increased participation by retail investors and competitive pressure may lead to lower transaction costs.

In response to Regulatory Notices 14-52 and 15-36, some commenters stated that the costs associated with increased pricing disclosure may lead some dealers to exit the retail market. Some commenters noted that the requirement to disclose pricing information if the firm principal trade and the customer trade occurred on the same trading day would disproportionately impact smaller firms, as larger firms would be more

able to hold positions overnight and not trigger the proposed requirement.

For each dealer's retail-size customer trades in corporate bonds in 3Q15, the staff estimated the percentage of trades with offsetting same-day principal transactions. While large firms had a lower average percentage of matched trades than small firms, the difference appeared to be much greater between firms that were more active in the retail corporate bond market and firms that were less active.[25] For example, for the top 20 firms that are most active in the retail corporate bond market (as measured by the total number of retail-size customer trades in principal capacity in the corporate bond market in 3Q15), on average 52 percent of the trades made by those firms qualified as matched trades.[26] In contrast, the average percentage of matched trades was 88 percent for all other firms. Therefore, it is possible that large firms and firms that are more active in the retail corporate bond market have greater capacity to hold inventory and source retail trades from that inventory, and therefore are less likely to trigger the proposed disclosure requirement.

Large firms and firms that are more active in the retail corporate bond market may respond to this proposal differently than other firms. Market participants indicated to FINRA that the costs of altering the trade processing and reporting systems for instances where the triggering principal trade occurred after the customer trade would be

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25 FINRA considers firms with 150 or fewer registered representatives as small firms and 500 or more as large firms. The average percentage of matched retail-size customer transactions of corporate bonds in 3Q15 was 89 percent for small firms and 82 percent for large firms. The difference was statistically significant. While the most active firms in the retail corporate bond market tend to be large, well-known firms, there are exceptions.

26 As retail transactions are proxied by trades of 100 bonds or less, some retail-size trades by the more active firms may be institutional transactions.

substantial. FINRA anticipates that large and more active firms are more likely to provide the disclosure to all retail customers even where a triggering principal trade has not occurred at the time of the customer trade because it would likely be less expensive than other methods of ensuring compliance with the proposed rule. FINRA understands that it is unlikely for less active firms to trade with a retail customer without an offsetting transaction. In the cases that they do, they may choose not to provide the disclosure to all retail customers, but then incur the costs of providing the trade processing information at the end of the day, cancelling and correcting the confirmation trade report at the end of the day for any retail trade that subsequently met the reporting requirements of the proposed rule. It is also possible that firms may choose to avoid entering into any trade that would subsequently trigger a reporting obligation, e.g., by holding a position overnight.

More generally, FINRA understands that some firms are considering providing the mark-up/mark-down disclosure on all retail trades, regardless of whether the dealers' offsetting trade is made within the same day or not. Similarly, some firms have proposed to provide mark-up/mark-down disclosure on both retail and non-retail transactions to lower the costs associated with identifying disclosure-eligible trades. Providing any additional disclosure would be voluntary to firms, and would likely only occur where the benefits, including reduced implementation costs, outweighed the costs imposed. For example, a firm that voluntarily provides disclosure on all retail principal transactions (regardless of whether there was an offsetting transaction on the same trading day) would be able to avoid the forward-looking aspect of the proposal and its associated costs. As well, providing additional disclosures may limit the differential impact on smaller firms.

And, as discussed above, FINRA notes that any intentional delay of a customer execution to avoid the proposed rule would be contrary to a firm's duties to customers under Rules 2010 and 5310. If the proposed rule is approved, FINRA will monitor trading patterns to ensure firms are not purposely delaying a customer execution to avoid the disclosure.

The staff also analyzed TRACE data for 3Q15 to understand the relationship between mark-ups and firm characteristics. The analysis finds that large firms and firms that are more active in the retail corporate bond market tend not to be represented within the tail of the largest estimated mark-ups and mark-downs in the distribution in the sample examined. For example, large firms accounted for 85 percent of all retail-size customer purchases of investment grade corporate bonds in 3Q15, but only 61 percent of the trades with the highest estimated mark-ups (above the 95th percentile).[27] Similarly, the top 20 firms as measured by the total number of retail-size customer trades in principal capacity in the corporate bond market in 3Q15 accounted for 68 percent of all retail-size customer purchases of investment grade corporate bonds in 3Q15, but only 28 percent of the trades with the highest estimated mark-ups. These relationships remain significant after controlling for bond and execution characteristics. To the extent that the proposed disclosure may lead to changes in investor and firm behaviors, it can logically be anticipated to have a greater impact on firms currently charging relatively high mark-ups and mark-downs. Therefore, the analysis implies that the associated economic costs may be higher to some small firms and firms less active in retail customer trades.

However, it is important to note that small firms tend to be overrepresented within both the tail of the highest and the tail of the lowest mark-ups and mark-downs in the

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[27] The sample only includes customer transactions that can be matched with offsetting same-day principal trades.

sample examined. In other words, while a disproportionate number of small firms charged relatively high mark-ups, there were also a disproportionate number of small firms that charged relatively low mark-ups. For example, small firms accounted for 8 percent of all retail-size customer purchases of investment grade corporate bonds in 3Q15, but 18 percent of the trades with the lowest estimated mark-ups (below the 5th percentile). This implies that some small firms offering competitive prices may benefit from the proposed disclosure.

Moreover, small firms are more likely to have their customer confirmations generated by clearing firms. To the extent that clearing firms will not pass along the full implementation costs to each introducing firm, small firms may incur lower costs than large firms to comply with the proposed rule change.

Therefore, while it is possible that the costs associated with the proposal may lead small dealers to consolidate with large dealers or to exit the market, the effect may be limited. FINRA recognizes that increased concentration in the retail market for fixed income transactions could impact retail costs, by either increasing or decreasing those costs. FINRA also recognizes the potential for members to shift some of the compliance costs on to customers.

(iv) Other Considerations

As initially proposed, FINRA would have required members to disclose a "reference price," which used a baseline that is derived from the price that was actually paid by the firm for the bond that same day, and the differential between that reference price and the price to the customer. In response to both the initial proposal and the revised proposal, commenters raised concerns about the usefulness of reference price

disclosure, and the potential burdens associated with implementing such disclosure. Based on concerns raised by commenters about the potential burdens associated with reference price disclosure, FINRA is now amending the proposal to require mark-up disclosure, as determined from the prevailing market price. FINRA believes that requiring mark-up disclosure rather than reference price disclosure may result in lower compliance costs, as members are already required under Rule 2121 to ensure that mark-ups and mark-downs are fair, and therefore should be calculating mark-ups to ensure compliance with Rule 2121. While FINRA notes that some members may generate customer confirmations on an intra-day basis, FINRA notes that the mark-up on the customer trade should generally be established at the time of that trade, which should reduce the impact of this proposal upon the confirmation generation process. While firms may still need to delay confirmation generation until the end of the day for at least some portion of disclosure-eligible trades due to the forward-looking aspect of the proposal, FINRA again notes that firms that voluntarily choose to provide disclosure on all retail trades could continue to provide confirmations intra-day, as the forward-looking aspect of the proposal would no longer be relevant.

FINRA recognizes that the determination of the prevailing market price may not be identical across firms and thus may result in a lack of comparability or consistency in disclosures, especially for thinly traded securities. FINRA expects that firms have reasonable policies and procedures in place to calculate the prevailing market price in a manner consistent with Rule 2121 and that such policies and procedures are applied consistently across customers.

FINRA believes that requiring disclosure for non-institutional accounts may lessen some of the costs and complexity associated with this proposal by allowing firms to use an existing distinction that already is integrated into their operations.

(d) Alternatives Considered

As discussed above and below, FINRA considered several alternative approaches and modified the proposal to reduce potential burdens and costs on member firms. For example, FINRA had proposed the disclosure of a "reference price," but then amended the proposal to require the disclosure of the mark-up or mark-down from the prevailing market price. Similarly, a "qualifying size" requirement was replaced with an exclusion for transactions that involve an institutional account. In response to comments and concerns, FINRA also proposes to exclude from the proposed disclosure those transactions which are part of fixed-price offerings on their first trading day and which are sold at the fixed-price offering price, and firm-side transactions that are conducted by a department or desk that is functionally separate from the retail-side desk. Where the member's principal trade was executed with an affiliate of the member in a transaction that was not at arms-length, FINRA proposes to require a member to "look through" its trade with the affiliate to the affiliate's trade with the third party to determine whether disclosure is required.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

This proposal was published for comment in Regulatory Notice 14-52 (November 2014) and Regulatory Notice 15-36 (October 2015). Thirty-two comments were received

in response to Regulatory Notice 14-52,[28] and eighteen comments were received in

[28] See Letter from Michael Nicholas, CEO, Bond Dealers of America, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("BDA Letter I"); letter from John T. Macklin, Director of Operations, Brean Capital, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Brean Letter"); letter from Richard Bryant, President, Capital Investment Group, to Marcia E. Asquith, Corporate Secretary, FINRA, dated August 4, 2015 ("CIG Letter"); letter from Micah Hauptman, Financial Services Counsel, Consumer Federation of America, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("CFA Letter I"); letter from Chris Melton, Executive Vice President, Coastal Securities, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 16, 2015 ("Coastal Securities Letter I"); letter from Michael S. Nichols, Principal, Cutter Advisors Group, dated December 5, 2014 ("Cutter Letter"); letter from Larry E. Fondren, President and CEO, DelphX LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 7, 2015 ("DelphX Letter"); Letter from Herbert Diamant, President, Diamant Investments Corp., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 9, 2015 ("Diamant Letter I"); letter from Robert A. Eder, to Cynthia Friedlander, FINRA, dated December 30, 2014 ("Eder Letter I"); letter from Robert A. Eder, dated April 1, 2015 ("Eder Letter II); letter from Norman L. Ashkenas, CCO, Fidelity Brokerage Services LLC and Richard J. O'Brien, CCO, National Financial Services, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Fidelity Letter I"); letter from Darren Wasney, Program Manager, Financial Information Forum, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("FIF Letter I"); letter from David T. Bellaire, Executive Vice President and General Counsel, Financial Services Institute, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("FSI Institute Letter I"); letter from Rick Foster, Vice-President and Senior Counsel, Financial Services Roundtable, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Financial Services Roundtable Letter"); letter from Fintegra, LLC ("Fintegra Letter"); letter from Alexander I. Rorke, Senior Managing Director, Hilliard Lyons, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Hilliard Letter"); letter from Thomas E. Dannenberg, President and CEO, Hutchinson Shockey Erley and Co., to Ronald W. Smith, Corporate Secretary, MSRB, dated January 20, 2015; letter from Andrew Hausman, President, Interactive Data, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Interactive Data Letter"); letter from Scott A. Hayes, President and CEO, Institutional Securities Corp., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 2, 2015 ("ISC Letter"); letter from Vincent Lumia, Managing Director, Morgan Stanley Smith Barney LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Morgan Stanley Letter I"); letter from Jed Bandes, President, Mutual Trust Co. of America Securities, dated December 23, 2014 ("Mutual Trust Letter"); letter from Hugh D. Berkson, Executive Vice-President, Public Investors Arbitration Bar Association, to Marcia E. Asquith, Corporate Secretary, FINRA, dated

response to Regulatory Notice 15-36.[29] A copy of Regulatory Notice 14-52 is attached as

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January 20, 2015 ("PIABA Letter I"); letter from Joseph R.V. Romano, President, Romano Brothers and Co., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 19, 2015 ("Romano Letter"); letter from Paige W. Pierce, President and CEO, RW Smith & Associates, LLC, dated January 21, 2015 ("RW Smith Letter I"); letter from Rick A. Fleming, Investor Advocate, SEC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("SEC Investor Advocate Letter I"); letter from Sean Davy, Managing Director and David L. Cohen, Managing Director, SIFMA, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("SIFMA Letter I"); letter from Robert A. Muh, CEO, Sutter Securities Inc., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Sutter Securities Letter"); letter from Karin Tex, dated January 12, 2015 ("Tex Letter"); letter from Kyle C. Wootten, Deputy Director – Compliance and Regulatory, Thomson Reuters, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 16, 2015 ("Thomson Reuters Letter I"); letter to Cynthia Friedlander from Scott D. Baines, Principal, Umpqua Investments, Inc., dated January 20, 2015 ("Umpqua Investments Letter"); letter from Bonnie K. Wachtel, CEO, and Wendie L. Wachtel, COO, Wachtel and & Co Inc., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 16, 2015 ("Wachtel Letter"); letter from Robert J. McCarthy, Director of Regulatory Policy, Wells Fargo Advisors, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Wells Fargo Letter I").

[29] See Letter from Michael Nicholas, Bond Dealers of America, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("BDA Letter II"); letter from Micah Hauptman, Consumer Federation of America, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("CFA Letter II"); letter from Kurt N. Schacht and Linda L. Rittenhouse, CFA Institute, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("CFA Institute Letter"); letter from Chris Melton, Coastal Securities, to Marcia E. Asquith, Corporate Secretary, FINRA ("Coastal Securities Letter II"); letter from Herbert Diamant, Diamant Investment Corporation, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 30, 2015 ("Diamant Letter II"); letter from Norman L. Ashkenas and Richard J. O'Brien, Fidelity Investments, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("Fidelity Letter II"); letter from Darren Wasney, Financial Information Forum, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("FIF Letter II"); letter from David T. Bellaire, Financial Services Institute, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015, ("FSI Institute Letter II"); letter from David P. Bergers, LPL Financial LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 10, 2015 ("LPL Letter"); letter from Elizabeth Dennis, Morgan Stanley Smith Barney LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("Morgan Stanley Letter II"); letter from Hugh D. Berkson, Public Investors Arbitration Bar Association, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December

Exhibit 2a. A list of comment letters received in response to Regulatory Notice 14-52 is attached as Exhibit 2b, and copies of the comment letters received in response to Regulatory Notice 14-52 are attached as Exhibit 2c. A copy of Regulatory Notice 15-36 is attached as Exhibit 2d. A list of comment letters received in response to Regulatory Notice 15-36 is attached as Exhibit 2e, and copies of the comment letters received in response to Regulatory Notice 15-36 are attached as Exhibit 2f.

Summary of Initial Proposal and Comments Received

As proposed in Regulatory Notice 14-52, if a firm sold to a customer and bought the same security as principal from another party on the same trading day, the firm would have been required to disclose on the customer confirmation (i) the price to the customer; (ii) the price to the firm of the same-day trade (reference price); and (iii) the difference between those two prices.[30] The initial proposal would apply where the transaction with the customer was of a "qualifying size," of 100 bonds or less or bonds with a face value

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8, 2015 ("PIABA Letter II"); letter from Paige W. Pierce, RW Smith and Associates, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("RW Smith Letter II"); letter from Jason Clague, Charles Schwab and Co., to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("Schwab Letter"); letter from Rick A. Fleming, Office of the Investor Advocate, SEC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("SEC Investor Advocate Letter II"); letter from Sean Davy and Leslie M. Norwood, Securities Industry and Financial Markets Association, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("SIFMA Letter II"); letter from Manisha Kimmel, Thomson Reuters, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("Thomson Reuters Letter II"); letter from Thomas S. Vales, TMC Bonds LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("TMC Bonds Letter"); letter from Robert J. McCarthy, Wells Fargo Advisors LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("Wells Fargo Letter II").

30 The initial proposal would also apply to instances where the firm buys bonds from a customer and sells the same bonds as principal to another party on the same trading day.

of $100,000 or less, which was designed to capture those trades that are retail in nature.

Of the 31 comments FINRA received on the proposal, 6 supported the proposal, while 25 commenters generally opposed the proposal or made recommendations on ways to narrow substantially the scope of the proposal. Generally, commenters that supported the proposal stated that the proposed confirmation disclosure would provide additional post-trade information to investors that would be otherwise difficult to ascertain.[31] Three commenters, including the CFA and the SEC Investor Advocate, stated that this additional information would put investors in a better position to assess whether they are paying fair prices and the quality of the services provided by their broker-dealer, and also could assist investors in detecting improper practices.[32] The CFA and DelphX indicated that the proposal would foster increased price competition in fixed income markets, which would ultimately lower investors' transaction costs.[33] Two commenters recommended that the proposal not be limited to retail trades under the proposed size threshold, but that disclosure should be made on all trades involving retail customers, regardless of size.[34]

Other commenters opposed the proposal on several grounds. Commenters questioned whether the proposed disclosure would provide investors with useful information,[35] or whether the disclosure would simply create confusion among

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31 See, e.g., SEC Investor Advocate Letter I at 2.

32 See CFA Letter I at 1; DelphX Letter at 2; SEC Investor Advocate Letter I at 2.

33 See CFA Letter I at 1; DelphX Letter at 3.

34 See Eder Letter I at 1; PIABA Letter I at 2.

35 See Diamant Letter at 5; Romano Letter at 3-4; Sutter Securities Letter at 2.

investors.[36] Commenters asserted that the proposed methodology for calculating the reference price is overly complex[37] and would be costly for firms to implement.[38] Commenters also indicated the proposal could cause some dealers to exit the retail broker market, either because firms would be reluctant to adapt to the new disclosure requirement, or because of increased costs and the potentially lower profits.[39]

Several commenters suggested ways to narrow the scope of the proposal. Some commenters recommended that FINRA limit the disclosure obligation to riskless principal transactions involving retail investors, as this would more accurately reflect dealer compensation and transaction costs,[40] and would be more consistent with the stated objectives of the SEC in this area and of the proposal itself.[41] Some commenters suggested that the proposed rule should apply to riskless principal transactions as previously defined by the Commission, wherein the broker-dealer has an "order in hand"

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36 See BDA Letter I at 4-5; Diamant Letter I at 6; FSI Institute Letter I at 3; Morgan Stanley Letter I at 2; SIFMA Letter I at 17; Wells Fargo Letter I at 5; CIG Letter at 1.

37 See Fidelity Letter I at 4; FIF Letter I at 2; SIFMA Letter I at 24-26; Thomson Reuters Letter I at 6; Wells Fargo Letter I at 8.

38 See BDA Letter I at 2-3; Diamant Letter I at 7-8; Fidelity Letter I at 4-5; FIF Letter I at 2; FSI Institute Letter I at 5; Financial Services Roundtable Letter at 5; Morgan Stanley Letter I at 3; Wells Fargo Letter I at 7-8; Umpqua Investments Letter at 1.

39 See Brean Letter at 1; Diamant Letter I at 7; FSI Institute Letter I at 8; Umpqua Investments Letter at 1.

40 See Hilliard Letter at 2; Morgan Stanley Letter I at 2; SIFMA Letter I at 29; Wells Fargo Letter I at 11.

41 See SIFMA Letter I at 31.

at the time of execution.[42] One commenter, however, did not think that such a limitation would appreciably reduce the complexity or cost of the proposal.[43] Commenters also suggested that FINRA eliminate institutional trades from the scope of the proposal: for example, by not covering institutional accounts as defined in FINRA Rule 4512, or sophisticated municipal market professionals as defined in MSRB Rule D-15.[44] Both Fidelity and SIFMA stated that the proposal should permit trading desks that are separately operated within a firm to match only their own trades for purposes of pricing disclosure.[45] Morgan Stanley and SIFMA also stated that transactions between affiliates should not constitute a firm principal trade that, if accompanied by a same-day customer trade, would trigger the disclosure requirement.[46] Commenters also suggested that the proposal exempt the disclosure of mark-ups on new issues.[47] One commenter suggested that this exemption should exempt the disclosure of mark-up/mark-downs on transactions in new issues executed at the public offering price on the date of the issue's sale.[48]

Rather than proposing reference price disclosure, several commenters suggested that FINRA instead enhance TRACE, in part by providing greater investor education

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42 See Hilliard Letter at 2; SIFMA Letter I at 30; Wells Fargo Letter I at 11.

43 See Thomson Reuters Letter at 7.

44 See BDA Letter I at 6; FIF Letter I at 3; Morgan Stanley Letter I at 3.

45 See Fidelity Letter I at 8; SIFMA Letter I at 36.

46 See Morgan Stanley Letter I at 3; SIFMA Letter I at 21.

47 See BDA Letter I at 6; Coastal Securities Letter I at 1; SIFMA Letter I at 22.

48 See Coastal Securities Letter I at 1.

about TRACE,[49] and requiring firms to make those systems more accessible[50] by, for example, providing more near-real-time TRACE information to investors[51] or providing a link to TRACE on customer confirmations,[52] or by aggregating all TRACE data on a single website.[53]

In response to the comments received on Regulatory Notice 14-52, FINRA proposed several modifications to the proposal. First, FINRA proposed to replace the qualifying size requirement with an exclusion for transactions that involve an institutional account, as defined in FINRA Rule 4512(c). This would ensure that all eligible transactions involving retail customers, regardless of size or face amount, would be subject to the proposed disclosure and was responsive to firms' concerns about using disparate definitions of a retail customer. Second, FINRA proposed to exclude from the proposed disclosure those transactions which are part of fixed-price offerings on their first trading day and which are sold at the fixed-price offering price. Variable price offerings would remain subject to the proposed disclosure.[54]

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49 See Fidelity Letter I at 7; FSI Institute Letter I at 6-7; Financial Services Roundtable Letter at 6; Hilliard Letter at 3; Morgan Stanley Letter I at 2; SIFMA Letter I at 15-16.

50 See Thomson Reuters Letter I at 7.

51 See Wells Fargo Letter I at 7. Other commenters noted the difficulty of providing TRACE/EMMA data on the confirmation. See Romano letter at 4.

52 See Fidelity Letter I at 7; FSI Institute Letter I at 6; Hilliard Letter at 3; Morgan Stanley Letter I at 2; SIFMA Letter I at 15-16.

53 See FIF Letter I at 4; FSI Institute Letter I at 6; Romano Letter at 3-4; SIFMA Letter I at 15-16.

54 In a fixed-price offering, bonds are generally sold at par and at the same price to all investors, and the compensation paid to the firm, such as the underwriting fee, is captured in the prospectus. In contrast, variable price offerings are reported as

Third, in response to concerns from commenters that having the disclosure requirements triggered by trades made by separate trading departments or desks would undermine the legal and operational separation of those desks, FINRA staff proposed to exclude firm-side transactions from the proposed disclosure that are conducted by a department or desk that is functionally separate from the retail-side desk, e.g., where the firm can demonstrate through policies and procedures that the firm-side transaction was made by an institutional desk for an institutional customer that is separate from the retail desk and the retail customer, and that the institutional desk had no knowledge of the retail order. However, if, for example, the transactions and positions of the separate department or desk are regularly used to effect the transactions at the retail desk, this exception would not apply.

Fourth, in response to concerns from commenters about having the disclosure requirements triggered by trades between affiliates, FINRA proposed to exclude trades where the member's principal trade was executed with an affiliate of the member and the affiliate's position that satisfied this trade was not acquired on the same trading day. Some commenters stated that acquiring a security through an affiliate was functionally similar to an inventory trade, and that using this trade as the basis for a reference price calculation would be of limited value, especially if the affiliate acquired its position over multiple trading days.[55] To the extent that disclosure is not required where the firm principal trade occurs on a previous trading day, e.g., the firm sells the security to a customer out of its inventory, this exception would apply a similar concept to trades

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secondary trades, may involve investors paying different prices, and may be difficult for firms to distinguish from other kinds of secondary trades.

55 See SIFMA Letter I at 21.

involving affiliates. Fifth, to address concerns raised by commenters that customers may be confused by reference price information provided on volatile trading days where there are large price swings between the time of the trade with the customer and the firm's own trade, FINRA proposed that firms be required to provide a link to TRACE on the customer confirmation, and permitted firms to omit the reference price in the event of a material change in the price of the security between the time of the firm principal trade and the customer trade. Sixth, in response to concerns about the operational burdens associated with determining the reference price for certain "complex" trade scenarios, FINRA would permit members to use alternative methodologies for more complex trades.[56]

As discussed above, FINRA developed its initial proposal in consultation with the MSRB, and the initial FINRA and MSRB proposals were substantially similar. However, in response to comments, the MSRB proposed a different disclosure framework than FINRA. Specifically, the MSRB proposed requiring a firm to disclose the amount of the firm's mark-up (or mark-down) from the prevailing market price for certain retail customer transactions, rather than the reference price paid by the firm and

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56 FINRA proposed that, where there is a principal transaction and a customer transaction of the same size (or the principal transaction exceeds the size of the customer trade) without intervening trades within the same trading day, the price of the principal trade should be used as the reference price. However, where there is not a same-size principal and customer trade scenario or there are one or more intervening trades of a different size, the staff proposed that firms should be allowed to employ a reasonable alternative methodology in calculating the reference price, such as the average weighted price of the firm trades that equal or exceed the size of the customer trade, or the price of the last same-day trade executed as principal by the firm prior to the customer trade (or closest in time if executed after), irrespective of the size of that principal trade. FINRA also proposed that the firm must adequately document, and consistently apply, its chosen methodology.

the differential between the reference price and the price paid by the customer. Under the MSRB's proposal, the firm would be required to disclose its mark-up or mark-down if the firm bought (sold) the security in one or more transactions in an aggregate trade size that met or exceeded the size of the sale (purchase) to (from) the customer within two hours of the customer transaction. The disclosed mark-up would be required to be expressed both as a total dollar amount and as a percentage. The MSRB also proposed exempting firms from disclosure when the firm and customer trades were conducted by functionally separate trading desks. For trades among affiliates, the MSRB proposed to "look through" the firm's trade with the affiliate to the affiliate's trade with the third party for purposes of determining whether disclosure is required. Additionally, the MSRB proposed to require the disclosure of two additional data points, even if mark-up disclosure would not be required under the MSRB's proposal. First, the MSRB proposed to require firms to add a CUSIP-specific link to EMMA on all customer confirmations. Second, the MSRB proposed to require on all customer confirmations the disclosure of the time of execution of a customer's trade.

Given the importance of achieving a coordinated approach with the MSRB, in Regulatory Notice 15-36 soliciting comment on the revised proposal, FINRA included a description of the MSRB's mark-up disclosure approach and invited comments on any relative merits and shortcomings of the MSRB's approach as compared to FINRA's revised approach.

Summary of Revised Proposal and Comments Received

In response to the revised proposal, some commenters reiterated that retail investors would benefit from some form of enhanced price disclosure. For example, the

CFA stated that increased price disclosure would provide investors with the opportunity to make more informed investment decisions, and would foster increased price competition in the fixed income markets.[57] The SEC Investor Advocate stated that some kind of regulatory solution was necessary, as retail investors in fixed income securities "remain disadvantaged by the lack of information they receive in confirmation statements."[58] The PIABA stated that abuse of undisclosed mark-ups and mark-downs is not a hypothetical problem, and that making additional pricing information available could result in customers being charged more favorable prices.[59]

A number of commenters supported disclosing the mark-up, as based on the prevailing market price, instead of the reference price.[60] BDA recommended that the disclosure should be displayed either in dollar terms or as a percentage of the mark-up relative to the inter-dealer price.[61] Both BDA and Schwab stated that the reference price proposal would be costly, difficult for firms to implement and for retail customers to understand, and may not provide customers with meaningful information about the costs associated with particular transactions.[62] Schwab noted that, under the reference price proposal, a customer may receive disclosure for the execution of one lot of a particular

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57 See CFA Letter II at 6.

58 See SEC Investor Advocate Letter II at 2.

59 See PIABA Letter II at 3.

60 See BDA Letter II at 6; Fidelity Letter II at 5; FSI Institute Letter II at 5; LPL Letter at 1; Schwab Letter at 3-4; SEC Investor Advocate Letter II at 5.

61 See BDA Letter II at 2.

62 See BDA Letter II at 4-5; Schwab Letter at 2.

order, but not for another lot of the same order.[63] Schwab stated that the reference price proposal would also reflect market fluctuations, so that a customer may infer that the dealer lost money on a transaction with a customer, even if a mark-up was charged.[64] Fidelity stated that the proposed disclosure requirement should focus on the difference between the price the customer was charged for a fixed income security and the prevailing market price of the fixed income security.[65] While Fidelity agreed that a dealer's actual contemporaneous costs or proceeds are a reasonable proxy for the prevailing market price in some situations, it stated that there are many situations in which a dealer's costs or proceeds are not a reasonable proxy for the prevailing market price.[66] Fidelity proposed that the prevailing market price be defined as the dealer's best available price for the subject security under the best available market at the time of trade execution.[67] Fidelity proposed different methodologies that dealers could apply when determining the prevailing market price, including (1) looking at a trader's mark-to-market at the end of the day; (2) contemporaneous cost; (3) top of book; and (4) vendor solutions that offer real time valuations for certain securities.[68]

Other commenters noted that the reference price proposal could negatively impact

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63 See Schwab Letter at 2.

64 See Schwab Letter at 2.

65 See Fidelity Letter II at 7-8.

66 Id.

67 Id. at 7.

68 Id. at 8.

firms' efforts to generate timely confirmations.[69] In supporting the mark-up disclosure approach, the SEC Investor Advocate noted that mark-up disclosure, although it may lead to disclosure of a smaller cost to an investor under some circumstances, nonetheless provides relevant information about the actual compensation the investor is paying the dealer for the transaction, reflects market conditions and has the potential to provide a more accurate benchmark for calculating transaction costs.[70] LPL noted that mark-up disclosure would be relevant to retail transactions in all kinds of fixed income securities that might be the subject of future disclosure requirements.[71]

Some commenters opposed requiring that the firm principal and customer trades occur closer in time to each other, such as two hours, as had relatedly been proposed by the MSRB. The CFA and the SEC Investor Advocate noted that a shorter timeframe would increase the possibility that firms would attempt to evade the disclosure requirement by holding onto positions.[72] Other commenters, including Morgan Stanley and SIFMA, indicated that the timeframe for disclosure should be shortened to the two-hour window.[73] These commenters stated that the two-hour window would capture the majority of the trades at issue, and also be easier to implement.[74] Commenters stated that the concern that a shorter timeframe would facilitate gaming of the disclosure

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69 See Fidelity Letter II at 11; FIF Letter II at 3; Schwab Letter at 4.

70 See SEC Investor Advocate Letter II at 5.

71 See LPL Letter at 4.

72 See CFA Letter II at 2; SEC Investor Advocate Letter II at 5.

73 See Diamant Letter II at 7; Morgan Stanley Letter II at 3; SIFMA Letter II at 7.

74 See Diamant Letter II at 7; Morgan Stanley Letter II at 3; SIFMA Letter II at 7.

requirement was misplaced, as it was unlikely that firms would change trading patterns and increase risk exposure merely to avoid disclosure.[75] They also said that FINRA has sufficient access to data to determine if firms were attempting to game the two-hour disclosure window.[76]

Commenters generally supported the change of the scope of the proposal from the "qualifying size" standard (transactions involving 100 bonds or less or $100,000 face amount or less) to transactions with non-institutional accounts.[77] The CFA noted that the revised standard would help ensure that all retail transactions would receive disclosure, regardless of size.[78]

Three commenters opposed the proposal to require firms to disclose the time of the execution of the customer transaction.[79] FIF stated that this proposal would create additional expense for firms, and could not be adjusted in connection with any trade modifications, cancellations or corrections.[80] FIF also indicated that the execution time was not necessary for securities that trade infrequently, as investors should not have

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75 See Morgan Stanley Letter II at 3; RW Smith Letter II at 2; SIFMA Letter II at 10.

76 See RW Smith Letter II at 2.

77 See CFA Letter II at 4; CFA Institute Letter at 3; Coastal Securities Letter II; PIABA Letter II at 2; Schwab Letter at 5; SIFMA Letter II at 15.

78 See CFA Letter II at 4.

79 See FIF Letter at 5; Schwab Letter at 6; SIFMA Letter at 16.

80 See FIF Letter at 5.

difficulty ascertaining the prevailing market price at the time of their trade.[81] Schwab indicated that this would not be a necessary data point for investors.[82]

Other commenters, however, supported including the time of execution of the customer trade. Thomson Reuters stated that including the time of execution would allow retail investors to more easily identify relevant trade data on TRACE[83] and FSI stated that this would allow investors to understand the market for their security at the time of their trade.[84]

Commenters also supported adding a general link to TRACE.[85] FSI and SIFMA supported the proposal to add a link to the TRACE website on customer confirmations instead of a CUSIP-specific link, as a CUSIP-specific link could be inaccurate or misleading, and could be difficult for firms to implement.[86] BDA stated that a general link to the main TRACE page would be operationally easier to achieve.[87]

Commenters supported the proposed exclusion for transactions involving separate trading desks,[88] although Schwab indicated that this exception should be subject to information barriers and rigorous oversight.[89] The CFA suggested FINRA specifically

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81 See FIF Letter at 6.

82 See Schwab Letter at 6.

83 See Thomson Reuters Letter at 2.

84 See FSI Letter at 7.

85 See BDA Letter II at 3; Coastal Securities Letter II; FSI Institute Letter II at 6.

86 See FSI Institute Letter II at 6; SIFMA Letter II at 19.

87 See BDA Letter II at 3.

88 See CFA Institute Letter at 5; Schwab Letter at 6; SIFMA Letter II at 15.

89 See Schwab Letter at 6.

require, in the rule text, that firms have policies and procedures in place to ensure functional separation,[90] and the SEC Investor Advocate suggested that FINRA provide greater guidance as to what constitutes a functional separation.[91]

Some commenters supported the proposal, in cases of transactions between affiliates, to "look through" to the affiliate's principal transaction for purposes of determining whether disclosure is required.[92] FIF and Thomson Reuters stated, however, that not all firms are able to "look through" principal trades, given information barriers and the fact that firms often conduct inter-dealer business on a completely separate platform than the retail business.[93]

With respect to the proposed exemption for fixed-price new issues, the two commenters that addressed this issue, CFA Institute and SIFMA, supported the proposed exemption.[94]

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.[95]

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90 See CFA Letter II at 5.

91 See SEC Investor Advocate Letter II at 6.

92 See CFA Institute Letter at 5; Fidelity Letter II at 11-12; PIABA Letter II at 2; Schwab Letter at 6; SIFMA Letter II at 18.

93 See FIF Letter II at 5; Thomson Reuters Letter II at 3.

94 See CFA Institute Letter at 4; SIFMA Letter II at 15.

95 15 U.S.C. 78s(b)(2).

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 2a. Regulatory Notice 14-52 (November 2014).

Exhibit 2b. List of comment letters received in response to Regulatory Notice 14-52.

Exhibit 2c. Comments received in response to Regulatory Notice 14-52.

Exhibit 2d. Regulatory Notice 15-36 (October 2015).

Exhibit 2e. List of comment letters received in response to Regulatory Notice 15-36.

Exhibit 2f. Comments received in response to Regulatory Notice 15-36.

Exhibit 5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2016-032)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change Relating to FINRA Rule 2232 (Customer Confirmations) to Require Members to Disclose Additional Pricing Information on Retail Customer Confirmations Relating to Transactions in Fixed Income Securities

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "SEA")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on , Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA 2232 (Customer Confirmations) to require members to disclose additional pricing information on retail customer confirmations relating to transactions in fixed income securities.

The text of the proposed rule change is available on FINRA's website at http://www.finra.org, at the principal office of FINRA and at the Commission's Public Reference Room.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

FINRA is proposing to amend Rule 2232 to require members to provide additional pricing information on customer confirmations in connection with non-municipal fixed income transactions with retail customers. Specifically, if a member trades as principal with a non-institutional customer in a corporate debt or agency debt security, the member must disclose the member's mark-up or mark-down from the prevailing market price for the security on the customer confirmation, if the member also executes one or more offsetting principal transaction(s) on the same trading day on the same side as the customer trade, the aggregate size of which meets or exceeds the size of the customer trade.

While members are already required, pursuant to SEA Rule 10b-10, to provide customers with pricing information, including transaction cost information, in connection with transactions in equity securities where the member acted as principal, no comparable

requirement currently exists for transactions in fixed income securities.[3] Based on statistics that are discussed in greater detail below, FINRA believes that some customers pay materially higher mark-ups or mark-downs in retail size trades than other customers for the same fixed income security. FINRA believes that the proposed requirement will provide meaningful and useful pricing information to retail customers in fixed income securities. FINRA believes that the proposal will better enable customers to evaluate the cost and quality of the execution service that members provide, will promote transparency into firms' pricing practices, and will encourage communications between firms and their customers about the pricing of their fixed income transactions.

As described in greater detail in Item II.C. below, FINRA initially solicited comment on a related proposal in Regulatory Notice 14-52 ("initial proposal"),[4] and subsequently on a revised proposal in Regulatory Notice 15-36 ("revised proposal").[5] FINRA also has been working with the MSRB to develop similar proposals, as appropriate, to ensure consistent disclosures to customers across debt securities and to reduce the operational burdens for firms that trade multiple fixed income securities. As

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3 See 17 CFR 240.10b-10. Under Rule 10b-10, where a member is acting as principal for its own account and is not a market maker in an equity security, and receives a customer order in that equity security that it executes by means of a principal trade to offset the contemporaneous trade with the customer, the rule requires the member to disclose the difference between the price to the customer and the dealer's contemporaneous purchase (for customer purchases) or sale price (for customer sales). See Rule 10b-10(a)(2)(ii)(A). Where the firm acts as principal for any other transaction in an NMS stock, or an equity security that is listed on a national securities exchange and is subject to last sale reporting, the rule requires the member to report the reported trade price, the price to the customer in the transaction, and the difference, if any, between the reported trade price and the price to the customer. See Rule 10b-10(a)(2)(ii)(B).

4 See Regulatory Notice 14-52 (November 2014).

5 See Regulatory Notice 15-36 (October 2015).

such, the MSRB has been developing its own pricing information disclosure proposal, and FINRA and the MSRB published their initial and revised proposals concurrently.[6] FINRA understands that the MSRB intends to file a substantially similar rule change.

Provided below is a more detailed description of each aspect of the proposed rule change.

Scope of the Disclosure Requirement

The proposed rule applies where the member buys (or sells) a security on a principal basis from (or to) a non-institutional customer and engages in one or more offsetting principal trades on the same trading day in the same security, where the size of the member's offsetting principal trade(s), in the aggregate, equals or exceeds the size of the customer trade. A non-institutional customer is a customer account that is not an institutional account, as defined in Rule 4512(c).[7] In addition, the proposed rule applies only to transactions in corporate debt securities, as defined in the proposed rule,[8] and

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6 See MSRB Regulatory Notice 2015-16 (September 2015), MSRB Regulatory Notice 2014-20 (November 2014).

7 Rule 4512(c) defines an institutional account as an account of "(1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million."

8 The proposed 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) or an Asset-Backed Security as defined in Rule 6710(cc)."

agency debt securities, as defined in Rule 6710(l).[9]

FINRA believes that the proposed rule provides meaningful pricing information to individual investors that would most benefit from such disclosure, while not imposing unduly burdensome disclosure requirements on members. FINRA believes that requiring disclosure for retail customers, i.e., accounts that are not institutional accounts, is appropriate because retail customers typically have less ready access to market and pricing information than institutional customers. FINRA believes that using the definition of an institutional account as set forth in Rule 4512(c) to define the scope of the proposal is appropriate because firms use this definition in other rule contexts, therefore reducing the implementation costs associated with this proposal.[10]

Same Day Triggering Timeframe

FINRA believes that it is appropriate to require disclosure of the mark-up or mark-down where the firm's offsetting principal trade(s) equaled or exceeded the size of

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9 Rule 6710(l) defines an agency debt security as "a debt security (i) issued or guaranteed by an Agency as defined in paragraph (k); or (ii) issued or guaranteed by a Government-Sponsored Enterprise as defined in paragraph (n). The term excludes a U.S. Treasury Security as defined in paragraph (p) and a Securitized Product as defined in paragraph (m), where an Agency or a Government-Sponsored Enterprise is the Securitizer as defined in paragraph (s) (or similar person), or the guarantor of the Securitized Product." To make the proposed changes to Rule 2232 applicable to agency debt securities, as part of this proposal, FINRA will amend Rule 0150 to add Rule 2232 to the list of FINRA rules that apply to "exempted securities," except municipal securities.

10 As discussed in greater detail below, FINRA initially proposed that the disclosure requirement would apply to customer trades of a "qualifying size," which was defined as customer transactions involving 100 bonds or less or bonds with a face amount of $100,000 or less, based on reported quantity. In response to comments that the proposed size-based standard could either exclude retail customer transactions above that amount from the proposed disclosure, or subject institutional transactions below that amount to the proposed disclosure, FINRA revised the proposal to incorporate the Rule 4512(c) definition of an institutional account.

the customer trade on the same trading day. To the extent that a member will often use its contemporaneous cost or proceeds, e.g., the price it paid or received for the bond, as the prevailing market price for purposes of calculating the mark-up or mark-down, FINRA believes that limiting the disclosure to those instances where there is an offsetting trade in the same trading day will reduce the variability of the mark-up and mark-down calculation.

As is discussed in greater detail in Item II.C., a number of commenters stated that the window for triggering disclosure should be limited to two hours. Among other things, commenters argued that a two-hour window would be easier to implement, and would more closely capture riskless principal trades, which would align the proposed disclosure to the riskless principal disclosure requirements for equity securities under Rule 10b-10.

As is also discussed below, FINRA has generated statistics, based on trade data reported to the Trade Reporting and Compliance Engine ("TRACE"), that indicate that the majority of firm principal/customer trades that occur within the same trading day occur within thirty minutes of one another. Nonetheless, FINRA believes that there are added benefits to requiring disclosure for trades that occur within the same trading day, rather than only trades that occur within two hours. First, the full-day window will ensure that more investors receive mark-up or mark-down disclosure, even where their trades occur more than two-hours from the firm principal trade (but still occur on the same trading day). Second, the full-day window may make members less likely to alter their trading patterns in response to the proposed rule, as members would be required to

hold positions overnight to avoid the proposed disclosure.[11] Finally, as is discussed further below, TRACE data for 3Q15 shows a material difference between the median mark-up/mark-down and the mark-ups/mark-downs at the tail of the distribution, indicating that some customers (those at the tail of the distribution) paid considerably more than others (at the median of the distribution). This data indicates that there is variability in the difference in prices paid in both firm principal and customer trades that occurred close in time to one another, e.g., within 30 minutes, and in firm principal and customer trades that did not occur close in time to one another. Based on this data, FINRA believes that the proposed disclosure would provide valuable information for customers whose trades occurred on the same trading day as the firm principal trade, regardless of whether those trades occurred close in time.

Some commenters recommended that FINRA limit the disclosure obligation to riskless principal transactions involving retail investors, as this would more accurately reflect dealer compensation and transaction costs, and would be more consistent with the stated objectives of the SEC in this area. These commenters would apply the proposed rule to riskless principal transactions as previously defined in the equity context by the

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[11] It is important to note that, under Rule 5310 (Best Execution and Interpositioning), members must use reasonable diligence to ascertain the best market for the security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. Supplementary Material .01 to Rule 5310 further emphasizes that a member must make every effort to execute a marketable customer order that it receives fully and promptly. Any intentional delay of a customer execution to avoid the proposed rule or otherwise would be contrary to these duties to customers. If the proposed rule change is approved, FINRA will monitor trading patterns to ensure firms are not purposely delaying a customer execution to avoid the disclosure. A firm found to purposefully delay the execution of a customer order to avoid the proposed disclosure may be in violation of the proposed rule, Rule 5310 and Rule 2010 (Standards of Commercial Honor and Principles of Trade).

Commission, where the broker-dealer has an "order in hand" at the time of execution. However, FINRA believes that it may be difficult to objectively define, implement and monitor a riskless principal trigger standard for fixed income securities and also believes that using the riskless principal standard ultimately is too narrow and that customers will benefit from the disclosure irrespective of whether the firm's capacity on the transaction was riskless principal.

Non-Arms-Length Affiliate Transactions

With respect to the offsetting principal trade(s), where a member buys from, or sells to, certain affiliates, the proposal would require the member to "look through" the member's transaction with the affiliate to the affiliate's transaction with a third party in determining when the security was acquired and whether the "same trading day" requirement has been triggered. Specifically, FINRA proposes to require members to apply the "look through" where a member's transaction with its affiliate was not at arms-length. For purposes of the proposed rule change, an "arms-length transaction" would be considered a transaction that was conducted through a competitive process in which non-affiliate firms could also participate—e.g., pricing sought from multiple firms, or the posting of multiple bids and offers—and where the affiliate relationship did not influence the price paid or proceeds received by the member. As a general matter, FINRA would expect that the competitive process used in an "arms-length" transaction, e.g., the request for pricing or platform for posting bids and offers, is one in which non-affiliates have frequently participated. FINRA believes that sourcing liquidity through a non-arms-length transaction with an affiliate is functionally equivalent to selling out of its own inventory for purposes of the proposed disclosure trigger. FINRA therefore believes it is

appropriate in those circumstances to require a member to "look through" its transaction with its affiliate to the affiliate's transaction with a third party to determine whether the proposed rule applies in these circumstances.[12]

Exceptions for Functionally Separate Trading Desks and Fixed-price Offerings

The proposed rule also contains two exceptions from the proposed disclosure requirement. First, if the offsetting same day firm principal trade was executed by a trading desk that is functionally separate from the firm's trading desk that executed the transaction with the customer, the principal trade by that separate trading desk would not trigger the disclosure requirement. Firms must have in place policies and procedures reasonably designed to ensure that the functionally separate principal trading desk through which the member purchase or member sale was executed had no knowledge of the customer transaction.[13] FINRA believes that this exception is appropriate because it recognizes the operational cost and complexity that may result in requiring a firm principal trade executed by a separate, unrelated trading desk as the basis for determining whether a mark-up or mark-down disclosure is triggered on the customer confirmation.

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12 Similarly, in a non-arms-length transaction with an affiliate, the member also would be required to "look-through" to the affiliate's transaction with a third party and related cost or proceeds by the affiliate as the basis for determining the member's calculation of the mark-up or mark-down pursuant to Rule 2121 (Fair Prices and Commissions).

13 This exception is distinguished from the "look through" provision noted above, whereby the customer transaction is being sourced through a non-arms-length transaction with the affiliate. Under the separate trading desk exception, functionally separate trading desks are required to have policies and procedures in place that are reasonably designed to ensure that trades on the functionally separate desks are executed with no knowledge of each other and reflect unrelated trading decisions. Additionally, FINRA notes that this exception would only apply to determine whether or not the proposed disclosure requirement has been triggered; it does not change a member's existing requirements relating to the calculation of its mark-up or mark-down under Rule 2121.

For example, the exception would allow an institutional desk within a firm to service an institutional customer without necessarily triggering the disclosure requirement for an unrelated trade performed by a separate retail desk within the firm. At the same time, in requiring that the member have policies and procedures in place that are reasonably designed to ensure that the functionally separate principal trading desk had no knowledge of the customer transaction, FINRA believes that the exception is sufficiently rigorous to minimize concerns about the potential misuse of the exception. In other words, in the example above, the firm could not use the functionally separate trading desk exception to avoid the proposed disclosure requirement if trades at the institutional desk were used to source transactions at the retail desk.

FINRA also believes that this exception is appropriate and consistent with the concept of functional and legal separation that exists in connection with other regulatory requirements, such as SEC Regulation SHO, and notes that some members already maintain functionally separate trading desks to comply with these requirements.

Second, the proposed rule would not apply if the member acquired the security in a fixed-price offering and sold the security to non-institutional customers at the same fixed-price offering price on the day the securities were acquired. In a fixed-price offering, the compensation paid to the firm, such as the underwriting fee, is paid for by the issuer and described in the prospectus. Given the availability of information in connection with a fixed-price offering, FINRA believes that the proposed disclosure is not warranted in those instances where the security is sold at the fixed-price offering price.

Proposed Information to be Disclosed on the Customer Confirmation

If the transaction meets the criteria described above, the member would be required to disclose the member's mark-up or mark-down from the prevailing market price for the security. The mark-up or mark-down would be calculated in compliance with Rule 2121 and the supplementary material thereunder, and would be expressed both as a total dollar amount and as a percentage of the prevailing market price.[14] FINRA believes that it is appropriate to require firms to calculate the mark-up in compliance with Rule 2121, as Supplementary Material .02 to Rule 2121 provides extensive guidance on how to calculate the mark-up for the fixed income securities to which the proposal would apply, including a presumption to use contemporaneous cost or proceeds. While some commenters noted the operational cost and complexity of implementing a previous iteration of this proposal, FINRA notes that firms are currently subject to Rule 2121 and are required to evaluate the mark-ups that they charge in connection with trades to ensure that they are fair and not excessive.[15] FINRA notes that the proposal does not alter the

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14 FINRA and the MSRB conducted investor testing which indicated that investors found that disclosing the mark-up or mark-down both as a dollar amount and as a percentage of the prevailing market price would be more useful than only disclosing it in one of those forms.

FINRA and the MSRB also solicited comment on whether to require members to disclose additional information on the trade confirmation for trades with retail customers, including whether firms should provide a link to TRACE, and whether firms should disclose the time of the customer trade. In response to comments received and support based on investor testing, FINRA intends to submit a rule filing in the near future that proposes these requirements.

15 Because the proposed mark-up disclosure is not triggered unless an offsetting principal trade occurred on the same day, FINRA anticipates that the number of customer trades that will use a price other than the price of a contemporaneous trade as the prevailing market price are small. Using 3Q15 data, of the retail-size customer trades that have an offsetting firm principal trade on the same trading day, over 83 percent of those trades occurred within 30 minutes of each other. In

requirements of Rule 2121, or otherwise intend to modify how firms calculate mark-ups. FINRA recognizes that the determination of the prevailing market price of a particular security may not be identical across firms and FINRA will expect that firms have reasonable policies and procedures in place to calculate the prevailing market price and that such policies and procedures are applied consistently across customers. Although the Supplementary Material to Rule 2121 provides extensive guidance, to the extent that firms have additional interpretive questions on the application of Rule 2121 to specific scenarios, FINRA will issue additional guidance as necessary.

FINRA believes that the proposal will provide retail customers with several important benefits. As discussed above, members are not required to provide customers who buy or sell fixed income securities with the same pricing information regarding mark-ups and mark-downs as customers who buy or sell equity securities. FINRA believes that requiring mark-up/mark-down disclosure will provide retail investors in non-municipal fixed income securities in transactions covered by the rule with comparable information to what retail investors in equity securities currently receive. FINRA believes that this disclosure will better assist fixed income investors in understanding and comparing the transaction costs associated with their purchases and sales.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change no later than 90 days following Commission

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10.5 percent of these instances, an intervening trade, either by the same firm or a different market participant, occurred. Given the close time proximity between the majority of firm principal and customer trades, and the fact that most of these trades did not have an intervening trade, firms will typically use their contemporaneous cost as the prevailing market price.

approval. The effective date will be no later than 365 days following Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[16] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, and Section 15A(b)(9) of the Act,[17] which requires that FINRA rules not impose any burden on competition that is not necessary or appropriate.

FINRA believes that this proposed rule change is consistent with the Act because it will provide retail customers with meaningful and useful additional pricing information that retail customers cannot readily obtain through existing data sources such as TRACE. This belief is supported by investor testing, which indicates that investors find aspects of the proposed requirements useful, including disclosing the mark-up or mark-down both as a dollar amount and as a percentage of the prevailing market price. FINRA believes that some customers pay materially more for trades in fixed income securities than other customers in comparable trades. FINRA believes that the proposed rule will better enable customers to evaluate the cost of the services that members provide by helping customers understand mark-ups or mark-downs from the prevailing market prices in specific transactions. FINRA further believes that this type of information will promote transparency into members' pricing practices and encourage communications between

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16 15 U.S.C. 78o-3(b)(6).

17 15 U.S.C. 78o-3(b)(9).

members and their customers about the execution of their fixed income transactions. This proposal also will 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.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed changes will apply equally to all similarly situated members. Additionally, all members already have an obligation to calculate mark-ups to ensure compliance with Rule 2121.

Economic Impact Assessment

(a) Need for the Rule

FINRA is concerned that retail investors in fixed income securities currently are limited in their ability to understand and compare transaction costs associated with their purchases and sales. Investor testing conducted by FINRA and the MSRB reveals that investors lack a clear understanding of the concepts and definitions of mark-up and mark-down and their role in dealer compensation. The proposed disclosure is expected to provide retail investors with valuable pricing information, encourage investor participation in the fixed income markets, and foster price competition among dealers, which may lower transaction costs for retail transactions in fixed income securities.

The staff's analysis of TRACE data for 3Q15 finds a large difference between the estimated median mark-up/mark-down and the tail of the distribution, indicating that

some customers paid considerably more than others in similar trades.[18] For example, for retail size (100 or fewer bonds) investment grade corporate debt transactions in 3Q15, the median estimated mark-up on customer buy orders was 0.53 percent, whereas the 95th percentile was more than four times higher (2.23 percent), suggesting that while the mark-up was half a percent or less on 50 percent of these orders, five percent of the orders (representing approximately 7,000 trades) had mark-ups of more than two percent.[19] Similarly, the median estimated mark-up for retail size corporate debt transactions in high-yield and unrated securities in 3Q15 was 0.83 percent and the 95th percentile was 2.96 percent.

Some market participants suggested that the proposed disclosure might not be meaningful because the observed dispersion in mark-ups might be explained by bond- or execution-specific characteristics. The staff's analysis of TRACE data for 3Q15 does not find relationships between mark-ups and bond- or execution-specific characteristics that would fundamentally undermine the value of the proposed requirement.

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[18] The mark-up and mark-down calculations involved matching customer trades to offsetting same-day principal trades by the same dealer in the same CUSIP. This included matching same-sized trades as well as trades of different sizes where there was no same-sized match (e.g., a dealer purchase of 100 corporate bonds matched to two sales to customers of 50 corporate bonds each). The mark-ups (mark-downs) on customer buys (sells) correspond to the percentage difference in price in customer trades and the offsetting principal trade. In cases when the offsetting principal trade was also a customer trade, the combined mark-up and mark-down ("spread") on these roundtrip transactions was calculated as the percentage difference in price between the customer buy and the customer sell.

[19] Most matched trades occurred close in time to each other. For example, among mark-up pairs of retail size customer purchases in investment grade corporate bonds in 3Q15, approximately 80 percent of the paired trades occurred within 30 seconds of each other. Nonetheless, the estimated mark-ups and mark-downs were calculated based on matching customer trades to offsetting same-day principal trades by the same dealer in the same CUSIP, and thus may be different from the ones calculated based on the prevailing market price.

Specifically, some market participants asserted that high mark-ups might be adequate compensation for enhanced execution price. For example, it was argued that a dealer might reasonably charge a high mark-up on a customer purchase if the transaction price was lower than the prevailing market price. To examine the relationship between mark-up and price, the staff compared the price of each retail size customer purchase (sale) of a bond to all prices of retail size customer purchases (sales) of the same bond in 3Q15 to measure relative execution price.[20] The analysis finds that higher estimated mark-ups were associated with higher, not lower, purchase prices as compared to all the purchase prices of the same bond in the same quarter. For instance, for retail size customer purchases of investment grade corporate bonds, the trades with the lowest estimated mark-ups (below the fifth percentile) had an average price percentile ranking of 35. In contrast, the trades with the highest estimated mark-ups (above the 95th percentile) had an average price percentile ranking of 63.

Some market participants asserted that high mark-ups and mark-downs might be caused by exceptionally low transaction quantities. For example, it was argued that a high mark-up on a customer purchase order of only three bonds might be justified by the high search cost. The analysis of TRACE data for 3Q15 finds no evidence that the highest estimated mark-ups were associated with unusually low quantities. For instance,

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[20] The sample only includes customer transactions that can be matched with offsetting same-day principal trades. In addition, the staff notes that the metric of relative execution price would be less reliable if fixed income security prices fluctuated widely within 3Q15. However, the monthly volatility of 10-year Treasury rates in 3Q15 was always below the average level of the prior 10 years, indicating that the interest rate volatility was moderate during the quarter. Treasury securities are considered to be free of default risk, and therefore are commonly used as a reliable interest rate benchmark for a wide range of private market transactions.

for retail size customer purchases of investment grade corporate bonds, the median quantity of the trades with the highest estimated mark-ups (above the 95th percentile) was 20 bonds. Moreover, the median quantity did not change much for trades with different estimated mark-up levels.[21]

As discussed above, the mark-up and mark-down estimation involves matching same-sized trades as well as trades of different sizes where there was no same-sized match (e.g., a dealer purchase of 100 corporate bonds matched to two sales to customers of 50 corporate bonds each). Some market participants asserted that the practice of breaking down a large transaction into smaller offsetting customer trades might lead to lower mark-ups due to the economies of scale, and thus might help explain the observed dispersion in mark-ups. The analysis of TRACE data for 3Q15 finds that splitting a larger principal trade into multiple smaller offsetting customer trades was associated with higher, not lower, mark-ups.

The analysis of TRACE data for 3Q15 also shows that the observed differences in estimated mark-ups were unlikely to be solely driven by bond characteristics. The results for retail size customer purchases of investment grade corporate bonds serve as an example. Among the bonds that had the highest estimated mark-ups (above the 95th percentile), approximately 77 percent also had trades with estimated mark-ups below the median. Moreover, these 77 percent of bonds traded more frequently with estimated below-median mark-ups. Further, the staff's analysis finds that bonds with higher trading

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[21] The median quantity was 28 bonds for trades with mark-ups below the fifth percentile, 15 bonds for trades with mark-ups between the 25th and 50th percentiles, and 20 bonds for trades with mark-ups between the fifth and 10th percentiles, the 10th and 25th percentiles, the 50th and 75th percentiles, the 75th and 90th percentiles, and the 90th and 95th percentiles.

frequencies in 3Q15, and presumably higher liquidity, had higher estimated mark-ups.[22]

In conclusion, the observed large dispersion in mark-ups and mark-downs do not appear to principally reflect bond or execution characteristics. The proposed disclosure is expected to provide customers with valuable and consistent information to understand, compare and evaluate transaction costs associated with their trades.

(b) Economic Baseline

The proposal would impact broker-dealers in the retail market of corporate and agency debt securities by imposing confirmation disclosure requirements on certain customer transactions. In 3Q15, the average daily number of retail size customer trades was 18,330 in corporate debt securities and 676 in agency debt securities. The transactions were mainly concentrated among large firms. For example, the top 20 broker-dealers with the highest volumes accounted for roughly 70 percent of the transactions for both corporate and agency debt securities.

It is estimated that approximately 59 percent of the retail size customer trades in corporate debt securities in 3Q15 would have been subject to the disclosure requirement if the proposed rule had been in place.[23] These disclosure-eligible trades were reported by about 800 dealers but were concentrated among large dealers. As discussed above, dealers already have an obligation to calculate their mark-ups for principal transactions in non-municipal fixed income securities to ensure compliance with Rule 2121.

(c) Economic Impacts

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22 The analysis also finds a negative but limited impact of credit rating on the level of mark-ups.

23 The percentage of eligible transactions may be overestimated as some matched trades may be transactions with affiliates or other trading desks.

(i) Benefits

FINRA believes that the proposal will provide retail customers with meaningful and useful pricing information that these customers cannot readily obtain through TRACE data. As evidenced by investor testing, investors consider it important to know how much firms charge for transactions in fixed income securities, yet they are unfamiliar with mark-ups and mark-downs. FINRA believes that the pricing information will better enable customers to evaluate the cost and quality of the services that members provide by helping customers understand mark-ups or mark-downs from the prevailing market prices in specific transactions. FINRA further believes that this type of information will promote transparency into members' pricing practices and encourage communications between members and their customers about the pricing of their fixed income transactions. By providing additional pricing information to customers, this proposal may encourage customers to seek out other dealers that might offer more competitive prices for the services offered, which may incentivize members to offer more competitive prices to their retail customers. Any resulting reduction in the differential between the prevailing market price and the price paid by the customer would reduce transaction costs paid by investors and enhance investor confidence in the alignment between transaction costs and the value of the services received, which may encourage wider participation by investors in the retail segments of the corporate and agency debt market.[24]

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[24] FINRA notes that this proposal may also provide regulatory benefits, as disclosing additional pricing information to customers may assist them in detecting practices that are possibly improper, which would supplement FINRA's own surveillance and enforcement program.

(ii) Costs

FINRA recognizes that the proposal would impose burdens and costs on members. In both Regulatory Notices 14-52 and 15-36, FINRA specifically solicited comment on the potential costs of the proposal to members.[25] For example, in Regulatory Notice 15-36, FINRA asked about the anticipated costs to firms in developing and implementing systems to comply with the revised proposal and the anticipated on-going costs associated with the revised proposal. FINRA asked members to provide the estimates of these costs, and the assumptions underlying those estimates. While commenters stated that the initial and the revised proposals would impose significant implementation costs on firms, no commenters provided specific cost estimates or a framework to assess anticipated costs.

Among other things, the proposal would require members to develop and deploy a methodology to satisfy the disclosure requirement, identify trades subject to the disclosure, convey the mark-up on the customer confirmation, and adopt policies and procedures to track and ensure compliance with the requirement. To apply the "look through" to non-arms-length transactions with affiliates, members would also need to obtain the price paid or proceeds received and the time of the affiliate's trade with the third party. FINRA is also aware, however, that some members already provide a form of mark-up disclosure for their customers, and may therefore incur fewer costs in complying with the proposed disclosure requirement.

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25 Regulatory Notices 14-52 and 15-36 proposed to require members to disclose a "reference price," while this proposal requires mark-up disclosure, as determined from the prevailing market price. As discussed below, requiring mark-up disclosure rather than reference price disclosure may result in lower compliance costs.

The proposal would require firms to examine transactions occurring both before and after a customer trade execution to determine whether the trade is subject to the disclosure requirement. FINRA recognizes that the forward-looking approach (comparison to trades occurring after customer trades) may be difficult to implement in some current confirmation processing systems. Some firms with such systems stated that they would need to both maintain the current systems and build entirely new systems to comply with the proposed rule change. The operational impact of the proposal would be more material to these firms.

(iii) Effect on Competition

FINRA believes that the proposal would improve price transparency, enhance investor confidence, and promote price competition among dealers in the retail market of corporate and agency debt securities. Increased participation by retail investors and competitive pressure may lead to lower transaction costs.

In response to Regulatory Notices 14-52 and 15-36, some commenters stated that the costs associated with increased pricing disclosure may lead some dealers to exit the retail market. Some commenters noted that the requirement to disclose pricing information if the firm principal trade and the customer trade occurred on the same trading day would disproportionately impact smaller firms, as larger firms would be more able to hold positions overnight and not trigger the proposed requirement.

For each dealer's retail size customer trades in corporate bonds in 3Q15, the staff estimated the percentage of trades with offsetting same-day principal transactions. While large firms had a lower average percentage of matched trades than small firms, the difference appeared to be much greater between firms that were more active in the retail

corporate bond market and firms that were less active.[26] For example, for the top 20 firms that are most active in the retail corporate bond market (as measured by the total number of retail size customer trades in principal capacity in the corporate bond market in 3Q15), on average 52 percent of the trades made by those firms qualified as matched trades.[27] In contrast, the average percentage of matched trades was 88 percent for all other firms. Therefore, it is possible that large firms and firms that are more active in the retail corporate bond market have greater capacity to hold inventory and source retail trades from that inventory, and therefore are less likely to trigger the proposed disclosure requirement.

Large firms and firms that are more active in the retail corporate bond market may respond to this proposal differently than other firms. Market participants indicated to FINRA that the costs to altering the trade processing and reporting systems for instances where the triggering principal trade occurred after the customer trade would be substantial. FINRA anticipates that large and more active firms are more likely to provide the disclosure to all retail customers even where a triggering principal trade has not occurred at the time of the customer trade because it would likely be less expensive than other methods of ensuring compliance with the proposed rule. FINRA understands that it is unlikely for less active firms to trade with a retail customer without an offsetting

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26 FINRA considers firms with 150 or fewer registered representatives as small firms and 500 or more as large firms. The average percentage of matched retail size customer transactions of corporate bonds in 3Q15 was 89 percent for small firms and 82 percent for large firms. The difference was statistically significant. While the most active firms in the retail corporate bond market tend to be large, well-known firms, there are exceptions.

27 As retail transactions are proxied by trades of 100 bonds or less, some retail size trades by the more active firms may be institutional transactions.

transaction. In the cases that they do, they may choose not to provide the disclosure to all retail customers, but then incur the costs of providing the trade processing information at the end of the day, cancelling and correcting the confirmation trade report at the end of the day for any retail trade that subsequently met the reporting requirements of the proposed rule. It is also possible that firms may choose to avoid entering into any trade that would subsequently trigger a reporting obligation, e.g., by holding a position overnight.

More generally, FINRA understands that some firms are considering providing the mark-up/mark-down disclosure on all retail trades, regardless of whether the dealers' offsetting trade is made within the same day or not. Similarly, some firms have proposed to provide mark-up/mark-down disclosure on both retail and non-retail transactions to lower the costs associated with identifying disclosure-eligible trades. Providing any additional disclosure would be voluntary to firms, and would likely only occur where the benefits, including reduced implementation costs, outweighed the costs imposed. For example, a firm that voluntarily provides disclosure on all retail principal transactions (regardless of whether there was an offsetting transaction on the same trading day) would be able to avoid the forward-looking aspect of the proposal and its associated costs. As well, providing additional disclosures may limit the differential impact on smaller firms. And, as discussed above, FINRA notes that any intentional delay of a customer execution to avoid the proposed rule would be contrary to a firm's duties to customers under Rules 2010 and 5310. If the proposed rule is approved, FINRA will monitor trading patterns to ensure firms are not purposely delaying a customer execution to avoid the disclosure.

The staff also analyzed TRACE data for 3Q15 to understand the relationship between mark-ups and firm characteristics. The analysis finds that large firms and firms that are more active in the retail corporate bond market tend not to be represented within the tail of the largest estimated mark-ups and mark-downs in the distribution in the sample examined. For example, large firms accounted for 85 percent of all retail size customer purchases of investment grade corporate bonds in 3Q15, but only 61 percent of the trades with the highest estimated mark-ups (above the 95th percentile).[28] Similarly, the top 20 firms as measured by the total number of retail size customer trades in principal capacity in the corporate bond market in 3Q15 accounted for 68 percent of all retail size customer purchases of investment grade corporate bonds in 3Q15, but only 28 percent of the trades with the highest estimated mark-ups. These relationships remain significant after controlling for bond and execution characteristics. To the extent that the proposed disclosure may lead to changes in investor and firm behaviors, it can logically be anticipated to have a greater impact on firms currently charging relatively high mark-ups and mark-downs. Therefore, the analysis implies that the associated economic costs may be higher to some small firms and firms less active in retail customer trades.

However, it is important to note that small firms tend to be overrepresented within both the tail of the highest and the tail of the lowest mark-ups and mark-downs in the sample examined. In other words, while a disproportionate number of small firms charged relatively high mark-ups, there were also a disproportionate number of small firms that charged relatively low mark-ups. For example, small firms accounted for 8 percent of all retail size customer purchases of investment grade corporate bonds in

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[28] The sample only includes customer transactions that can be matched with offsetting same-day principal trades.

3Q15, but 18 percent of the trades with the lowest estimated mark-ups (below the 5th percentile). This implies that some small firms offering competitive prices may benefit from the proposed disclosure.

Moreover, small firms are more likely to have their customer confirmations generated by clearing firms. To the extent that clearing firms will not pass along the full implementation costs to each introducing firm, small firms may incur lower costs than large firms to comply with the proposed rule change.

Therefore, while it is possible that the costs associated with the proposal may lead small dealers to consolidate with large dealers or to exit the market, the effect may be limited. FINRA recognizes that increased concentration in the retail market for fixed income transactions could impact retail costs, by either increasing or decreasing those costs. FINRA also recognizes the potential for members to shift some of the compliance costs on to customers.

(iv) Other Considerations

As initially proposed, FINRA would have required members to disclose a "reference price," which used a baseline that is derived from the price that was actually paid by the firm for the bond that same day, and the differential between that reference price and the price to the customer. In response to both the initial proposal and the revised proposal, commenters raised concerns about the usefulness of reference price disclosure, and the potential burdens associated with implementing such disclosure. Based on concerns raised by commenters about the potential burdens associated with reference price disclosure, FINRA is now amending the proposal to require mark-up disclosure, as determined from the prevailing market price. FINRA believes that

requiring mark-up disclosure rather than reference price disclosure may result in lower compliance costs, as members are already required under Rule 2121 to ensure that mark-ups and mark-downs are fair, and therefore should be calculating mark-ups to ensure compliance with Rule 2121. While FINRA notes that some members may generate customer confirmations on an intra-day basis, FINRA notes that the mark-up on the customer trade should generally be established at the time of that trade, which should reduce the impact of this proposal upon the confirmation generation process. While firms may still need to delay confirmation generation until the end of the day for at least some portion of disclosure-eligible trades due to the forward-looking aspect of the proposal, FINRA again notes that firms that voluntarily choose to provide disclosure on all retail trades could continue to provide confirmations intra-day, as the forward-looking aspect of the proposal would no longer be relevant.

FINRA recognizes that the determination of the prevailing market price may not be identical across firms and thus may result in a lack of comparability or consistency in disclosures, especially for thinly traded securities. FINRA expects that firms have reasonable policies and procedures in place to calculate the prevailing market price in a manner consistent with Rule 2121 and that such policies and procedures are applied consistently across customers.

FINRA believes that requiring disclosure for non-institutional accounts may lessen some of the costs and complexity associated with this proposal by allowing firms to use an existing distinction that already is integrated into their operations.

(d) Alternatives Considered

As discussed above and below, FINRA considered several alternative approaches and modified the proposal to reduce potential burdens and costs on member firms. For example, FINRA had proposed the disclosure of a "reference price," but then amended the proposal to require the disclosure of the mark-up or mark-down from the prevailing market price. Similarly, a "qualifying size" requirement was replaced with an exclusion for transactions that involve an institutional account. In response to comments and concerns, FINRA also proposes to exclude from the proposed disclosure those transactions which are part of fixed-price offerings on their first trading day and which are sold at the fixed-price offering price, and firm-side transactions that are conducted by a department or desk that is functionally separate from the retail-side desk. Where the member's principal trade was executed with an affiliate of the member in a transaction that was not at arms-length, FINRA proposes to require a member to "look through" its trade with the affiliate to the affiliate's trade with the third party to determine whether disclosure is required.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

This proposal was published for comment in Regulatory Notice 14-52 (November 2014) and Regulatory Notice 15-36 (October 2015). Thirty-two comments were received in response to Regulatory Notice 14-52,[29] and eighteen comments were received in

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[29] See Letter from Michael Nicholas, CEO, Bond Dealers of America, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("BDA Letter I"); letter from John T. Macklin, Director of Operations, Brean Capital, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Brean Letter"); letter from Richard Bryant, President, Capital Investment Group, to Marcia E. Asquith, Corporate Secretary, FINRA, dated August 4, 2015 ("CIG

Letter"); letter from Micah Hauptman, Financial Services Counsel, Consumer Federation of America, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("CFA Letter I"); letter from Chris Melton, Executive Vice President, Coastal Securities, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 16, 2015 ("Coastal Securities Letter I"); letter from Michael S. Nichols, Principal, Cutter Advisors Group, dated December 5, 2014 ("Cutter Letter"); letter from Larry E. Fondren, President and CEO, DelphX LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 7, 2015 ("DelphX Letter"); Letter from Herbert Diamant, President, Diamant Investments Corp., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 9, 2015 ("Diamant Letter I"); letter from Robert A. Eder, to Cynthia Friedlander, FINRA, dated December 30, 2014 ("Eder Letter I"); letter from Robert A. Eder, dated April 1, 2015 ("Eder Letter II); letter from Norman L. Ashkenas, CCO, Fidelity Brokerage Services LLC and Richard J. O'Brien, CCO, National Financial Services, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Fidelity Letter I"); letter from Darren Wasney, Program Manager, Financial Information Forum, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("FIF Letter I"); letter from David T. Bellaire, Executive Vice President and General Counsel, Financial Services Institute, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("FSI Institute Letter I"); letter from Rick Foster, Vice-President and Senior Counsel, Financial Services Roundtable, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Financial Services Roundtable Letter"); letter from Fintegra, LLC ("Fintegra Letter"); letter from Alexander I. Rorke, Senior Managing Director, Hilliard Lyons, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Hilliard Letter"); letter from Thomas E. Dannenberg, President and CEO, Hutchinson Shockey Erley and Co., to Ronald W. Smith, Corporate Secretary, MSRB, dated January 20, 2015; letter from Andrew Hausman, President, Interactive Data, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Interactive Data Letter"); letter from Scott A. Hayes, President and CEO, Institutional Securities Corp., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 2, 2015 ("ISC Letter"); letter from Vincent Lumia, Managing Director, Morgan Stanley Smith Barney LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Morgan Stanley Letter I"); letter from Jed Bandes, President, Mutual Trust Co. of America Securities, dated December 23, 2014 ("Mutual Trust Letter"); letter from Hugh D. Berkson, Executive Vice-President, Public Investors Arbitration Bar Association, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("PIABA Letter I"); letter from Joseph R.V. Romano, President, Romano Brothers and Co., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 19, 2015 ("Romano Letter"); letter from Paige W. Pierce, President and CEO, RW Smith & Associates, LLC, dated January 21, 2015 ("RW Smith Letter I"); letter from Rick A. Fleming, Investor Advocate, SEC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("SEC Investor Advocate Letter I"); letter from Sean Davy, Managing Director and David L.

response to Regulatory Notice 15-36.[30] A copy of Regulatory Notice 14-52 is attached as Exhibit 2a. A list of comment letters received in response to Regulatory Notice 14-52 is

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Cohen, Managing Director, SIFMA, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("SIFMA Letter I"); letter from Robert A. Muh, CEO, Sutter Securities Inc., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Sutter Securities Letter"); letter from Karin Tex, dated January 12, 2015 ("Tex Letter"); letter from Kyle C. Wootten, Deputy Director – Compliance and Regulatory, Thomson Reuters, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 16, 2015 ("Thomson Reuters Letter I"); letter to Cynthia Friedlander from Scott D. Baines, Principal, Umpqua Investments, Inc., dated January 20, 2015 ("Umpqua Investments Letter"); letter from Bonnie K. Wachtel, CEO, and Wendie L. Wachtel, COO, Wachtel and & Co Inc., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 16, 2015 ("Wachtel Letter"); letter from Robert J. McCarthy, Director of Regulatory Policy, Wells Fargo Advisors, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 ("Wells Fargo Letter I").

30 See Letter from Michael Nicholas, Bond Dealers of America, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("BDA Letter II"); letter from Micah Hauptman, Consumer Federation of America, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("CFA Letter II"); letter from Kurt N. Schacht and Linda L. Rittenhouse, CFA Institute, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("CFA Institute Letter"); letter from Chris Melton, Coastal Securities, to Marcia E. Asquith, Corporate Secretary, FINRA ("Coastal Securities Letter II"); letter from Herbert Diamant, Diamant Investment Corporation, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 30, 2015 ("Diamant Letter II"); letter from Norman L. Ashkenas and Richard J. O'Brien, Fidelity Investments, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("Fidelity Letter II"); letter from Darren Wasney, Financial Information Forum, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("FIF Letter II"); letter from David T. Bellaire, Financial Services Institute, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015, ("FSI Institute Letter II"); letter from David P. Bergers, LPL Financial LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 10, 2015 ("LPL Letter"); letter from Elizabeth Dennis, Morgan Stanley Smith Barney LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("Morgan Stanley Letter II"); letter from Hugh D. Berkson, Public Investors Arbitration Bar Association, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 8, 2015 ("PIABA Letter II"); letter from Paige W. Pierce, RW Smith and Associates, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("RW Smith Letter II"); letter from Jason Clague, Charles Schwab and Co., to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("Schwab Letter"); letter from Rick A. Fleming, Office of the

attached as Exhibit 2b, and copies of the comment letters received in response to Regulatory Notice 14-52 are attached as Exhibit 2c. A copy of Regulatory Notice 15-36 is attached as Exhibit 2d. A list of comment letters received in response to Regulatory Notice 15-36 is attached as Exhibit 2e, and copies of the comment letters received in response to Regulatory Notice 15-36 are attached as Exhibit 2f.

Summary of Initial Proposal and Comments Received

As proposed in Regulatory Notice 14-52, if a firm sold to a customer and bought the same security as principal from another party on the same trading day, the firm would have been required to disclose on the customer confirmation (i) the price to the customer; (ii) the price to the firm of the same-day trade (reference price); and (iii) the difference between those two prices.[31] The initial proposal would apply where the transaction with the customer was of a "qualifying size," of 100 bonds or less or bonds with a face value of $100,000 or less, which was designed to capture those trades that are retail in nature.

Of the 31 comments FINRA received on the proposal, 6 supported the proposal, while 25 commenters generally opposed the proposal or made recommendations on ways

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Investor Advocate, SEC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("SEC Investor Advocate Letter II"); letter from Sean Davy and Leslie M. Norwood, Securities Industry and Financial Markets Association, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("SIFMA Letter II"); letter from Manisha Kimmel, Thomson Reuters, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("Thomson Reuters Letter II"); letter from Thomas S. Vales, TMC Bonds LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("TMC Bonds Letter"); letter from Robert J. McCarthy, Wells Fargo Advisors LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 ("Wells Fargo Letter II").

31 The initial proposal would also apply to instances where the firm buys bonds from a customer and sells the same bonds as principal to another party on the same trading day.

to narrow substantially the scope of the proposal. Generally, commenters that supported the proposal stated that the proposed confirmation disclosure would provide additional post-trade information to investors that would be otherwise difficult to ascertain.[32] Three commenters, including the CFA and the SEC Investor Advocate, stated that this additional information would put investors in a better position to assess whether they are paying fair prices and the quality of the services provided by their broker-dealer, and also could assist investors in detecting improper practices.[33] The CFA and DelphX indicated that the proposal would foster increased price competition in fixed income markets, which would ultimately lower investors' transaction costs.[34] Two commenters recommended that the proposal not be limited to retail trades under the proposed size threshold, but that disclosure should be made on all trades involving retail customers, regardless of size.[35]

Other commenters opposed the proposal on several grounds. Commenters questioned whether the proposed disclosure would provide investors with useful information,[36] or whether the disclosure would simply create confusion among investors.[37] Commenters asserted that the proposed methodology for calculating the

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32 See, e.g., SEC Investor Advocate Letter I at 2.

33 See CFA Letter I at 1; DelphX Letter at 2; SEC Investor Advocate Letter I at 2.

34 See CFA Letter I at 1; DelphX Letter at 3.

35 See Eder Letter I at 1; PIABA Letter I at 2.

36 See Diamant Letter at 5; Romano Letter at 3-4; Sutter Securities Letter at 2.

37 See BDA Letter I at 4-5; Diamant Letter I at 6; FSI Institute Letter I at 3; Morgan Stanley Letter I at 2; SIFMA Letter I at 17; Wells Fargo Letter I at 5; CIG Letter at 1.

reference price is overly complex[38] and would be costly for firms to implement.[39] Commenters also indicated the proposal could cause some dealers to exit the retail broker market, either because firms would be reluctant to adapt to the new disclosure requirement, or because of increased costs and the potentially lower profits.[40]

Several commenters suggested ways to narrow the scope of the proposal. Some commenters recommended that FINRA limit the disclosure obligation to riskless principal transactions involving retail investors, as this would more accurately reflect dealer compensation and transaction costs,[41] and would be more consistent with the stated objectives of the SEC in this area and of the proposal itself.[42] Some commenters suggested that the proposed rule should apply to riskless principal transactions as previously defined by the Commission, wherein the broker-dealer has an "order in hand" at the time of execution.[43] One commenter, however, did not think that such a limitation would appreciably reduce the complexity or cost of the proposal.[44] Commenters also

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38 See Fidelity Letter I at 4; FIF Letter I at 2; SIFMA Letter I at 24-26; Thomson Reuters Letter I at 6; Wells Fargo Letter I at 8.

39 See BDA Letter I at 2-3; Diamant Letter I at 7-8; Fidelity Letter I at 4-5; FIF Letter I at 2; FSI Institute Letter I at 5; Financial Services Roundtable Letter at 5; Morgan Stanley Letter I at 3; Wells Fargo Letter I at 7-8; Umpqua Investments Letter at 1.

40 See Brean Letter at 1; Diamant Letter I at 7; FSI Institute Letter I at 8; Umpqua Investments Letter at 1.

41 See Hilliard Letter at 2; Morgan Stanley Letter I at 2; SIFMA Letter I at 29; Wells Fargo Letter I at 11.

42 See SIFMA Letter I at 31.

43 See Hilliard Letter at 2; SIFMA Letter I at 30; Wells Fargo Letter I at 11.

44 See Thomson Reuters Letter at 7.

suggested that FINRA eliminate institutional trades from the scope of the proposal: for example, by not covering institutional accounts as defined in FINRA Rule 4512, or sophisticated municipal market professionals as defined in MSRB Rule D-15.[45] Both Fidelity and SIFMA stated that the proposal should permit trading desks that are separately operated within a firm to match only their own trades for purposes of pricing disclosure.[46] Morgan Stanley and SIFMA also stated that transactions between affiliates should not constitute a firm principal trade that, if accompanied by a same-day customer trade, would trigger the disclosure requirement.[47] Commenters also suggested that the proposal exempt the disclosure of mark-ups on new issues.[48] One commenter suggested that this exemption should exempt the disclosure of mark-up/mark-downs on transactions in new issues executed at the public offering price on the date of the issue's sale.[49]

Rather than proposing reference price disclosure, several commenters suggested that FINRA instead enhance TRACE, in part by providing greater investor education about TRACE,[50] and requiring firms to make those systems more accessible[51] by, for

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45 See BDA Letter I at 6; FIF Letter I at 3; Morgan Stanley Letter I at 3.

46 See Fidelity Letter I at 8; SIFMA Letter I at 36.

47 See Morgan Stanley Letter I at 3; SIFMA Letter I at 21.

48 See BDA Letter I at 6; Coastal Securities Letter I at 1; SIFMA Letter I at 22.

49 See Coastal Securities Letter I at 1.

50 See Fidelity Letter I at 7; FSI Institute Letter I at 6-7; Financial Services Roundtable Letter at 6; Hilliard Letter at 3; Morgan Stanley Letter I at 2; SIFMA Letter I at 15-16.

51 See Thomson Reuters Letter I at 7.

example, providing more near-real-time TRACE information to investors[52] or providing a link to TRACE on customer confirmations,[53] or by aggregating all TRACE data on a single website.[54]

In response to the comments received on Regulatory Notice 14-52, FINRA proposed several modifications to the proposal. First, FINRA proposed to replace the qualifying size requirement with an exclusion for transactions that involve an institutional account, as defined in FINRA Rule 4512(c). This would ensure that all eligible transactions involving retail customers, regardless of size or face amount, would be subject to the proposed disclosure and was responsive to firms' concerns about using disparate definitions of a retail customer. Second, FINRA proposed to exclude from the proposed disclosure those transactions which are part of fixed-price offerings on their first trading day and which are sold at the fixed-price offering price. Variable price offerings would remain subject to the proposed disclosure.[55]

Third, in response to concerns from commenters that having the disclosure requirements triggered by trades made by separate trading departments or desks would undermine the legal and operational separation of those desks, FINRA staff proposed to

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52 See Wells Fargo Letter I at 7. Other commenters noted the difficulty of providing TRACE/EMMA data on the confirmation. See Romano letter at 4.

53 See Fidelity Letter I at 7; FSI Institute Letter I at 6; Hilliard Letter at 3; Morgan Stanley Letter I at 2; SIFMA Letter I at 15-16.

54 See FIF Letter I at 4; FSI Institute Letter I at 6; Romano Letter at 3-4; SIFMA Letter I at 15-16.

55 In a fixed-price offering, bonds are generally sold at par and at the same price to all investors, and the compensation paid to the firm, such as the underwriting fee, is captured in the prospectus. In contrast, variable price offerings are reported as secondary trades, may involve investors paying different prices, and may be difficult for firms to distinguish from other kinds of secondary trades.

exclude firm-side transactions from the proposed disclosure that are conducted by a department or desk that is functionally separate from the retail-side desk, e.g., where the firm can demonstrate through policies and procedures that the firm-side transaction was made by an institutional desk for an institutional customer that is separate from the retail desk and the retail customer, and that the institutional desk had no knowledge of the retail order. However, if, for example, the transactions and positions of the separate department or desk are regularly used to effect the transactions at the retail desk, this exception would not apply.

Fourth, in response to concerns from commenters about having the disclosure requirements triggered by trades between affiliates, FINRA proposed to exclude trades where the member's principal trade was executed with an affiliate of the member and the affiliate's position that satisfied this trade was not acquired on the same trading day. Some commenters stated that acquiring a security through an affiliate was functionally similar to an inventory trade, and that using this trade as the basis for a reference price calculation would be of limited value, especially if the affiliate acquired its position over multiple trading days.[56] To the extent that disclosure is not required where the firm principal trade occurs on a previous trading day, e.g., the firm sells the security to a customer out of its inventory, this exception would apply a similar concept to trades involving affiliates. Fifth, to address concerns raised by commenters that customers may be confused by reference price information provided on volatile trading days where there are large price swings between the time of the trade with the customer and the firm's own trade, FINRA proposed that firms be required to provide a link to TRACE on the

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56 See SIFMA Letter I at 21.

customer confirmation, and permitted firms to omit the reference price in the event of a material change in the price of the security between the time of the firm principal trade and the customer trade. Sixth, in response to concerns about the operational burdens associated with determining the reference price for certain "complex" trade scenarios, FINRA would permit members to use alternative methodologies for more complex trades.[57]

As discussed above, FINRA developed its initial proposal in consultation with the MSRB, and the initial FINRA and MSRB proposals were substantially similar. However, in response to comments, the MSRB proposed a different disclosure framework than FINRA. Specifically, the MSRB proposed requiring a firm to disclose the amount of the firm's mark-up (or mark-down) from the prevailing market price for certain retail customer transactions, rather than the reference price paid by the firm and the differential between the reference price and the price paid by the customer. Under the MSRB's proposal, the firm would be required to disclose its mark-up or mark-down if the firm bought (sold) the security in one or more transactions in an aggregate trade size that met or exceeded the size of the sale (purchase) to (from) the customer within two

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57 FINRA proposed that, where there is a principal transaction and a customer transaction of the same size (or the principal transaction exceeds the size of the customer trade) without intervening trades within the same trading day, the price of the principal trade should be used as the reference price. However, where there is not a same-size principal and customer trade scenario or there are one or more intervening trades of a different size, the staff proposed that firms should be allowed to employ a reasonable alternative methodology in calculating the reference price, such as the average weighted price of the firm trades that equal or exceed the size of the customer trade, or the price of the last same-day trade executed as principal by the firm prior to the customer trade (or closest in time if executed after), irrespective of the size of that principal trade. FINRA also proposed that the firm must adequately document, and consistently apply, its chosen methodology.

hours of the customer transaction. The disclosed mark-up would be required to be expressed both as a total dollar amount and as a percentage. The MSRB also proposed exempting firms from disclosure when the firm and customer trades were conducted by functionally separate trading desks. For trades among affiliates, the MSRB proposed to "look through" the firm's trade with the affiliate to the affiliate's trade with the third party for purposes of determining whether disclosure is required. Additionally, the MSRB proposed to require the disclosure of two additional data points, even if mark-up disclosure would not be required under the MSRB's proposal. First, the MSRB proposed to require firms to add a CUSIP-specific link to EMMA on all customer confirmations. Second, the MSRB proposed to require on all customer confirmations the disclosure of the time of execution of a customer's trade.

Given the importance of achieving a coordinated approach with the MSRB, in Regulatory Notice 15-36 soliciting comment on the revised proposal, FINRA included a description of the MSRB's mark-up disclosure approach and invited comments on any relative merits and shortcomings of the MSRB's approach as compared to FINRA's revised approach.

Summary of Revised Proposal and Comments Received

In response to the revised proposal, some commenters reiterated that retail investors would benefit from some form of enhanced price disclosure. For example, the CFA stated that increased price disclosure would provide investors with the opportunity to make more informed investment decisions, and would foster increased price competition in the fixed income markets.[58] The SEC Investor Advocate stated that some

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[58] See CFA Letter II at 6.

kind of regulatory solution was necessary, as retail investors in fixed income securities "remain disadvantaged by the lack of information they receive in confirmation statements."[59] The PIABA stated that abuse of undisclosed mark-ups and mark-downs is not a hypothetical problem, and that making additional pricing information available could result in customers being charged more favorable prices.[60]

A number of commenters supported disclosing the mark-up, as based on the prevailing market price, instead of the reference price.[61] BDA recommended that the disclosure should be displayed either in dollar terms or as a percentage of the markup relative to the inter-dealer price.[62] Both BDA and Schwab stated that the reference price proposal would be costly, difficult for firms to implement and for retail customers to understand, and may not provide customers with meaningful information about the costs associated with particular transactions.[63] Schwab noted that, under the reference price proposal, a customer may receive disclosure for the execution of one lot of a particular order, but not for another lot of the same order.[64] Schwab stated that the reference price proposal would also reflect market fluctuations, so that a customer may infer that the dealer lost money on a transaction with a customer, even if a mark-up was charged.[65]

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59 See SEC Investor Advocate Letter II at 2.

60 See PIABA Letter II at 3.

61 See BDA Letter II at 6; Fidelity Letter II at 5; FSI Institute Letter II at 5; LPL Letter at 1; Schwab Letter at 3-4; SEC Investor Advocate Letter II at 5.

62 See BDA Letter II at 2.

63 See BDA Letter II at 4-5; Schwab Letter at 2.

64 See Schwab Letter at 2.

65 See Schwab Letter at 2.

Fidelity stated that the proposed disclosure requirement should focus on the difference between the price the customer was charged for a fixed income security and the prevailing market price of the fixed income security.[66] While Fidelity agreed that a dealer's actual contemporaneous costs or proceeds are a reasonable proxy for the prevailing market price in some situations, it stated that there are many situations in which a dealer's costs or proceeds are not a reasonable proxy for the prevailing market price.[67] Fidelity proposed that the prevailing market price be defined as the dealer's best available price for the subject security under the best available market at the time of trade execution.[68] Fidelity proposed different methodologies that dealers could apply when determining the prevailing market price, including (1) looking at a trader's mark-to-market at the end of the day; (2) contemporaneous cost; (3) top of book; and (4) vendor solutions that offer real time valuations for certain securities.[69]

Other commenters noted that the reference price proposal could negatively impact firms' efforts to generate timely confirmations.[70] In supporting the mark-up disclosure approach, the SEC Investor Advocate noted that mark-up disclosure, although it may lead to disclosure of a smaller cost to an investor under some circumstances, nonetheless provides relevant information about the actual compensation the investor is paying the dealer for the transaction, reflects market conditions and has the potential to provide a

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66 See Fidelity Letter II at 7-8.

67 Id.

68 Id. at 7.

69 Id. at 8.

70 See Fidelity Letter II at 11; FIF Letter II at 3; Schwab Letter at 4.

more accurate benchmark for calculating transaction costs.[71] LPL noted that mark-up disclosure would be relevant to retail transactions in all kinds of fixed income securities that might be the subject of future disclosure requirements.[72]

Some commenters opposed requiring that the firm principal and customer trades occur closer in time to each other, such as two hours, as had relatedly been proposed by the MSRB. The CFA and the SEC Investor Advocate noted that a shorter timeframe would increase the possibility that firms would attempt to evade the disclosure requirement by holding onto positions.[73] Other commenters, including Morgan Stanley and SIFMA, indicated that the timeframe for disclosure should be shortened to the two-hour window.[74] These commenters stated that the two-hour window would capture the majority of the trades at issue, and also be easier to implement.[75] Commenters stated that the concern that a shorter timeframe would facilitate gaming of the disclosure requirement was misplaced, as it was unlikely that firms would change trading patterns and increase risk exposure merely to avoid disclosure.[76] They also said that FINRA has sufficient access to data to determine if firms were attempting to game the two-hour disclosure window.[77]

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71 See SEC Investor Advocate Letter II at 5.

72 See LPL Letter at 4.

73 See CFA Letter II at 2; SEC Investor Advocate Letter II at 5.

74 See Diamant Letter II at 7; Morgan Stanley Letter II at 3; SIFMA Letter II at 7.

75 See Diamant Letter II at 7; Morgan Stanley Letter II at 3; SIFMA Letter II at 7.

76 See Morgan Stanley Letter II at 3; RW Smith Letter II at 2; SIFMA Letter II at 10.

77 See RW Smith Letter II at 2.

Commenters generally supported the change of the scope of the proposal from the "qualifying size" standard (transactions involving 100 bonds or less or $100,000 face amount or less) to transactions with non-institutional accounts.[78] The CFA noted that the revised standard would help ensure that all retail transactions would receive disclosure, regardless of size.[79]

Three commenters opposed the proposal to require firms to disclose the time of the execution of the customer transaction.[80] FIF stated that this proposal would create additional expense for firms, and could not be adjusted in connection with any trade modifications, cancellations or corrections.[81] FIF also indicated that the execution time was not necessary for securities that trade infrequently, as investors should not have difficulty ascertaining the prevailing market price at the time of their trade.[82] Schwab indicated that this would not be a necessary data point for investors.[83]

Other commenters, however, supported including the time of execution of the customer trade. Thomson Reuters stated that including the time of execution would allow retail investors to more easily identify relevant trade data on TRACE[84] and FSI stated that this would allow investors to understand the market for their security at the

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78 See CFA Letter II at 4; CFA Institute Letter at 3; Coastal Securities Letter II; PIABA Letter II at 2; Schwab Letter at 5; SIFMA Letter II at 15.

79 See CFA Letter II at 4.

80 See FIF Letter at 5; Schwab Letter at 6; SIFMA Letter at 16.

81 See FIF Letter at 5.

82 See FIF Letter at 6.

83 See Schwab Letter at 6.

84 See Thomson Reuters Letter at 2.

time of their trade.[85]

Commenters also supported adding a general link to TRACE.[86] FSI and SIFMA supported the proposal to add a link to the TRACE website on customer confirmations instead of a CUSIP-specific link, as a CUSIP-specific link could be inaccurate or misleading, and could be difficult for firms to implement.[87] BDA stated that a general link to the main TRACE page would be operationally easier to achieve.[88]

Commenters supported the proposed exclusion for transactions involving separate trading desks,[89] although Schwab indicated that this exception should be subject to information barriers and rigorous oversight.[90] The CFA suggested FINRA specifically require, in the rule text, that firms have policies and procedures in place to ensure functional separation,[91] and the SEC Investor Advocate suggested that FINRA provide greater guidance as to what constitutes a functional separation.[92]

Some commenters supported the proposal, in cases of transactions between affiliates, to "look through" to the affiliate's principal transaction for purposes of

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85 See FSI Letter at 7.

86 See BDA Letter II at 3; Coastal Securities Letter II; FSI Institute Letter II at 6.

87 See FSI Institute Letter II at 6; SIFMA Letter II at 19.

88 See BDA Letter II at 3.

89 See CFA Institute Letter at 5; Schwab Letter at 6; SIFMA Letter II at 15.

90 See Schwab Letter at 6.

91 See CFA Letter II at 5.

92 See SEC Investor Advocate Letter II at 6.

determining whether disclosure is required.[93] FIF and Thomson Reuters stated, however, that not all firms are able to "look through" principal trades, given information barriers and the fact that firms often conduct inter-dealer business on a completely separate platform than the retail business.[94]

With respect to the proposed exemption for fixed-price new issues, the two commenters that addressed this issue, CFA Institute and SIFMA, supported the proposed exemption.[95]

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

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93 See CFA Institute Letter at 5; Fidelity Letter II at 11-12; PIABA Letter II at 2; Schwab Letter at 6; SIFMA Letter II at 18.

94 See FIF Letter II at 5; Thomson Reuters Letter II at 3.

95 See CFA Institute Letter at 4; SIFMA Letter II at 15.

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2016-032 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Robert W. Errett, Deputy Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2016-032. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You

should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2016-032 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[96]

Robert W. Errett
Deputy Secretary

[96] 17 CFR 200.30-3(a)(12).

Regulatory Notice 14-52

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

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

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.

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*; 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.[1]

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).[2]

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.[3] 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. [4]

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.[5] 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.[6]

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.[7] 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[8] to help customers assess the reasonableness of their dealer's compensation, as riskless principal transactions become more common in the fixed income markets.[9]

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.[10]

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.[11] 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:[12]

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.[13] 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.[14]

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.[15]

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.[16] 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.[17] 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.

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.

* * * * *

EXHIBIT 2b

Alphabetical List of Written Comments
Regulatory Notice 14-52

1. Norman Ashkenas, Fidelity Investments (January 20, 2015)
2. Scott D. Baines, Umpqua Investments, Inc. (January 20, 2015)
3. Jed Bandes, Mutual Trust Company of America Securities (December 5, 2014)
4. David T. Bellaire, Financial Services Institute (January 20, 2015)
5. Hugh D. Berkson, Public Investors Arbitration Bar Association (January 19, 2015)
6. Richard Bryant, Capital Investment Group, Inc. (August 4, 2015)
7. Thomas E. Dannenberg, Hutchinson, Shockey, Erley & Co. (January 20, 2015)
8. Sean Davy, Securities Industry and Financial Markets Association (January 20, 2015)
9. Herbert Diamant, Diamant Investment Corporation (January 9, 2015)
10. Robert A. Eder, (December 5, 2014)
11. Robert A. Eder, (April 1, 2015)
12. Fintegra, LLC. (December 5, 2014)
13. Rick Fleming, Securities and Exchange Commission (January 20, 2015)
14. Larry E. Fondren, DelphX, LLC. (January 7, 2015)
15. Richard Foster, Financial Services Roundtable (January 20, 2015)
16. Micah Hauptman, Consumer Federation of America (January 20, 2015)
17. Andrew Hausman, Interactive Data (January 20, 2015)
18. Scott A. Hayes, Institutional Securities Corporation (January 13, 2015)
19. Vincent Lumia, Morgan Stanley Smith Barney, LLC. (January 20, 2015)
20. John T. Macklin, Brean Capital, LLC. (January 20, 2015)

21. Robert J. McCarthy, Wells Fargo Advisors, LLC. (January 20, 2015)

22. Chris Melton, Coastal Securities (January 16, 2015)

23. Robert A. Muh, Sutter Securities (January 20, 2015)

24. Michael Nicholas, Bond Dealers of America (January 20, 2015)

25. Michael Nichols, Cutter Advisors Group (December 5, 2014)

26. Paige W. Pierce, RW Smith & Associates, LLC (January 21, 2015)

27. Joseph R.V. Romano, Romano Brothers & Co. Wealth Management (January 19, 2015)

28. Alexander I. Rorke, Hilliard Lyons (January 20, 2015)

29. Karin Tex, (January 24, 2015)

30. Bonnie K. Wachtel, Wachtel & Co., Inc. (January 19, 2015)

31. Darren Wasney, Financial Information Forum (January 20, 2015)

32. Kyle C. Wootten, Thomson Reuters (January 16, 2015)

January 20, 2015

Submitted electronically

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

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

MSRB Regulatory Notice 2014-20,
Request for Comment on Draft Rule Amendments to
Require Dealers to Provide Pricing Reference
Information on Retail Customer Confirmations

Dear Ms. Asquith and Mr. Smith:

Fidelity Investments[1] ("Fidelity") appreciates the opportunity to respond to the Financial Industry Regulatory Authority's ("FINRA's") Regulatory Notice 14-52 and the Municipal Securities Rulemaking Board's ("MSRB's") Regulatory Notice 2014-20 (together the "Proposals").[2] The Proposals seek to provide retail investors greater information on fixed income pricing by requiring brokers, dealers and municipal security dealers ("broker-dealers") to disclose, on customer confirmation statements, the price to the customer, the price to the broker-dealer, and the differential between those two prices for same-day, retail-size principal transactions in corporate, agency and municipal securities.

[1]Fidelity is one of the world's largest providers of financial services. Fidelity provides investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 20 million individuals and institutions, as well as through 10,000 financial intermediary firms. Fidelity generally agrees with the views expressed by the Securities Industry and Financial Markets Association ("SIFMA") in their comment letter to FINRA and we submit this letter to supplement the SIFMA letter on specific issues.

[2]*See* FINRA Regulatory Notice 14-52; Pricing Disclosure in the Fixed Income Markets (November 2014) *available at:* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p601685.pdf. ("FINRA Proposal") *See* MSRB Regulatory Notice 2014-20; Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations (November 2014) *available at:* http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-20.ashx?n=1 ("MSRB Proposal") Unless otherwise defined in this letter, capitalized terms have the meanings ascribed to them in the Proposals.

Fidelity submits this letter on behalf of Fidelity Brokerage Services LLC ("FBS"), a Securities and Exchange Commission ("SEC") registered introducing retail broker-dealer and FINRA member, and its affiliate, National Financial Services LLC ("NFS"), a SEC registered clearing firm and FINRA member. Both FBS and NFS are registered with the MSRB as municipal securities dealers. Fidelity's comments reflect the views of both an introducing broker-dealer and a clearing broker-dealer that will be affected by the Proposals.

Fidelity supports targeted, market-driven, pricing transparency efforts in the fixed income markets. Pricing transparency promotes robust competition among diverse market participants, which helps foster innovation and allows for greater investor choice.

Fidelity's fixed income pricing for its self-directed retail brokerage customers is transparent, simple and low for the brokerage industry. Fidelity provides its retail brokerage customers access to a wide selection of secondary market fixed income inventory sourced directly from third-party alternative trading systems (Tradeweb Direct, KCG Bondpoint and TMC Bonds), other national broker-dealers, and from its affiliate, Fidelity Capital Markets (FCM), a division of NFS. Bonds from FCM are treated on a par with bond offerings from unaffiliated third-party sources. When FCM is not the offering dealer, Fidelity's compensation is limited to a $1 per bond transaction fee for most fixed income securities. We disclose this fee in our retail brokerage commission schedule, on order preview pages at the point of trade on *Fidelity.com*, and via representatives in representative-assisted trades.

We believe that a $1 per bond transaction fee is a more transparent form of pricing for retail brokerage customers than mark-up based pricing and, in many cases, is more cost efficient. A 2013 study found that Fidelity was less expensive 98.6 percent of the time versus "mark-up based" brokers that bundle transaction fees with the price of the bond.[3]

Although we fully support regulatory efforts to enhance fixed income price transparency, we do not support the Proposals as currently written and believe they should be withdrawn. While well intentioned, we believe the Proposals will confuse rather than clarify fixed income pricing for retail investors because 1) they apply to a wider spectrum of trades than simply riskless principal transactions; 2) they apply to some, but not all, retail fixed income transactions; and 3) they use different terminology and disclosures to meet the same regulatory goal. The Proposals also present serious operational and logistical challenges that render them unworkable for many market participants. In place of the Proposals, we urge FINRA and the MSRB to consider alternatives that meet the same policy goals, such as further enhancements to existing fixed income price discovery tools for retail investors, *i.e.* FINRA's Trade Reporting and Compliance Engine ("TRACE") and the MSRB's Electronic Municipal Market Access ("EMMA") system.

[3]For further information regarding this study, see *Fidelity's Message for Retail Bond Investors: Comparison Shop — it Can Make a Big Difference* (September 20, 2013) *available at*: https://www.fidelity.com/about-fidelity/individual-investing/fidelitys-message-retail-bond-investors

The Proposals Will Not Help Retail Investors

For some time, regulators have considered requiring broker-dealers to disclose markups in "riskless principal" transactions.[4] Although "riskless principal" transactions are not defined in the Proposals, they are generally understood to mean purchases and sales done with a contemporaneous, offsetting customer order in hand, so there is little or no chance that the market could move against the broker-dealer.

The Proposals seek to ensure fairness and transparency around mark-ups in riskless principal transactions by requiring broker-dealers to provide mark-up disclosure on a subset of retail customer fixed income transactions that 1) match one or more same day principal orders and 2) meet certain size requirements.[5] We believe that the over- and under-inclusive scope of the Proposals will do little to clarify fixed income pricing for retail investors.

The Proposals require broker-dealers to identify all possible principal and customer matching scenarios for certain fixed income transactions over the course of a day and provide retail investors mark-up disclosure on these transactions, some of which may be "riskless principal" transactions, others not. In identifying matched trades, broker-dealers must navigate an overly complicated – and at times conflicting – matching methodology. For example, under certain circumstances, the Proposals specify a "last in first out" methodology for matching trades and under other circumstances, the Proposals specify a "weighted average price" methodology for matching trades. A potential result of this matching methodology is that a retail customer may receive pricing information on a composite of principal trades that simply happened to occur on the same day as his or her trade, but that are unrelated to their actual trade.

Moreover, the Proposals do not apply to all retail customer fixed income transactions. Retail customers will receive the proposed disclosure only on select transactions meeting established size and time criteria. Other fixed income transactions, not meeting size and time

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[4] *See* for example, Report on the Municipal Securities Market, U.S. Securities and Exchange Commission (July 31, 2012) and Speech by SEC Chair Mary Jo White *Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors* (June 20, 2014).

[5] The FINRA Proposal would require confirmation disclosure where a broker-dealer 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). This disclosure would include (i) the price to the customer; (ii) the price to the broker-dealer of the same-day trade; and (iii) the difference between those two prices. 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. The MSRB Proposal would require a dealer to disclose on the customer confirmation its trade price for a defined "reference transaction" as well as the difference in price between the reference transaction and the customer trade. A reference transaction is defined in the MSRB Proposal as one in which the dealer, as principal, purchases or sells the same security that is the subject of the confirmation on the same date as the customer trade. The disclosure requirement would be triggered only where the dealer is on the same side of the transaction as the customer (as purchaser or seller) and the size of such dealer transaction(s), in total, would equal or exceed the size of the customer transaction.

parameters, will not receive this disclosure. In the end, we fail to see how the Proposals will help retail investors who may, at best, be confused as to why this disclosure appears on some -- but not all -- of their fixed income transactions and at worst, receive broker-dealer pricing information on securities unrelated to their actual trade.

We also note that the Proposals use different terms, phrases and structures for initiatives designed to work together to meet the same regulatory goal. For example, FINRA's Proposal would require broker-dealers to disclose (i) the price to the customer; (ii) the price to the broker-dealer of the same-day trade; and (iii) the difference between those two prices, while the MSRB's Proposal would require a municipal securities dealer to disclose its trade price for a defined "reference transaction" as well as the difference in price between the reference transaction and the customer trade. These differences are likely to confuse retail investors who purchase a variety of fixed income products as well as impact implementation efforts at broker-dealers.

The Proposals Are Not Workable For Market Participants

The Proposals would add significant operational challenges and risks to the confirmation statement process by adding new layers and requirements onto already complex systems.

The Proposals would require broker-dealers to build a significant new system, at considerable cost, to match trades that meet an artificial definition of a riskless principal transaction.[6] By necessity, this system will need to identify all possible matching scenarios for all principal fixed income transactions over the course of the day and navigate an overly complicated – and at times conflicting – matching methodology. The application of these methodologies to situations where there is significant buying and selling activity at varying prices, varying sizes, and across varying business channels can quickly become quite complex.[7]

The operational challenges of the Proposals are especially significant for clearing broker-dealers that would likely be required to coordinate and rely on third parties for data necessary for compliance.

[6]At present, we believe that it would be a sizable effort simply to understand the costs of building a new system to identify "matched trades" under the various methodologies that FINRA and the MSRB have proposed.

[7]For example, at many financial services firms, a single broker-dealer is shared across multiple business units, complicating the matching of trades under the Proposals. Similarly, the Proposals do not address fairly common situations in which a dealers' institutional, retail, and proprietary trading desks operate independently, complicating whether and how transactions would or should be disclosed and/or matched across affiliated desks. It is also not clear how computations would be made, and what disclosure added, to customer confirmation in certain situations, *i.e.* if the customer trade was executed in partial fills, in the event of a cancelation or re-billing of a transaction, or in the case of an investment adviser block size purchase of bonds that was subsequently allocated to retail customer accounts.

Fully-disclosed clearing broker-dealers clear and settle millions of securities transactions each day for thousands of introducing broker-dealers.[8] Clearing broker-dealers do not sell securities to retail customers. Rather, a fully-disclosed clearing broker-dealer provides routine and ministerial "back office" processing services -- clearance and settlement and custody services -- to introducing broker-dealers. The relationship between the clearing broker-dealer and the introducing broker-dealer and the division of responsibilities between them is set forth in a fully disclosed clearing agreement, which is filed with and approved by FINRA before any clearing services may begin.

Among other back-office functions, clearing broker-dealers settle fixed income trades and print and mail end-customer confirmation statements for introducing broker-dealers. With considerable effort involving the review of multiple principal accounts across all of its introducing broker-dealers, a clearing broker-dealer could likely obtain access to the underlying details of when, how, and for how much the introducing broker-dealer obtained the fixed income security it ultimately sold to its end-customer. More likely, an introducing broker-dealer would need to submit information on a particular trade to its clearing broker-dealer at the end of the business day, after the introducing broker-dealer has determined this information itself.

Requiring matched trade information with a full day "look back" conflicts with how trade confirmation statements are processed today, increasing the risk that they will not be completed within regulatory timeframes. Industry standard processing of retail customer trade confirmations involves batching and pricing during the day, processing immediately after market close, overnight composition, with printing and mailing the next business day.[9] For example, at most clearing broker-dealers:

- During the business day, trading occurs in multiple channels throughout the organization and information on these trades moves throughout the day, in real time, to a single "trade prep" location;
- At this location, among other items, calculations are performed and consolidation work is done on the underlying data used to populate the trade confirmation;
- At market close, a file is sent from the "trade prep" location to a trade confirmation engine where the data is formatted and the trade confirmation is composed. This step typically takes place in the 10pm to 2am time window; and
- After the trade confirmation is composed, next steps include, but are not limited to, monitoring, paper fulfillment, or electronic fulfillment.

[8]Because many introducing broker-dealers (aka "correspondents") do not have the net capital, resources, technology, personnel or expertise to clear and settle their own trades, introducing broker-dealers often contract with a third-party clearing broker-dealers to carry their proprietary accounts (if any) and its end-customer accounts and perform back office functions on a fully-disclosed basis (*i.e.*, disclosed to the introducing firm's end customers).

[9]Trade confirmations to institutional customers are sent on a real-time basis through the DTCC system for trade affirmation. To the extent an institutional customer's fixed income trade met the size and dollar parameters of the Proposals, this process would require significant changes.

If the Proposals are approved as currently drafted, at the end of each business day, introducing broker-dealers will need to sift through all of their customer fixed income transaction data for the day to determine (i) which trades, out of the larger universe of customers trades executed that day, are subject to the disclosure requirements (ii) the price to the introducing broker-dealer of the fixed income security under several different complex methodologies and (iii) mark-up information on the trade, as applicable.

The introducing broker-dealer would then need to transmit this information to its clearing broker-dealer, who would be required to (i) identify the relevant trade out of the broader universe of trades for that day; (ii) pass this information to their trade confirmation engine; and (iii) update the particular trade file in the trade confirmation engine. All of this work would need to be performed, without error or delay, before the established deadlines for passing files to the trade confirmation engine to allow the clearing broker-dealer to print and mail the statement to the end-customer within established regulatory timeframes.

We believe that the current industry practice of processing of trades throughout the business day serves important risk mitigation purposes. Straight-through processing of trade confirmations provides transparency to fixed income trading that helps broker-dealers' risk management practices. The processing of trades throughout the business day also helps avoid bottlenecks that may affect the timely, accurate, and complete processing of retail customer trade confirmation statements.

The Proposals place significant time pressure on the confirmation statement process, particularly in light of current initiatives to shorten the settlement cycle. Exchange Act Rule 10b-10, FINRA Rule 2230 and MSRB Rule G-15 generally require broker-dealers that effect transactions in the account of a customer to provide a confirmation to the customer "at or before the completion of" such transaction. Exchange Act Rule 15c1-1(b) defines "the completion of the transaction" to be, generally, when the customer makes payment to the broker, or when the broker delivers the security to the account of the customer.

The Depository Trust & Clearing Corporation ("DTCC") is currently leading an industry effort to shorten the U.S. trade settlement cycle for equities, municipal and corporate bonds, and unit investment trusts ("UITs") from T+3 (trade date plus three days) to T+2 (trade date plus two days).[10] Once achieved, DTCC has recommended a pause and further assessment of industry readiness and appetite for a future move to T+1.[11] The tension between the Proposals' greater disclosure requirements, which can only be accessed and added to trade confirmation statements at the end of the day, and a shorter settlement cycle adds complexity and operational risk to the trade confirmation statement process and is a further reason why we believe the Proposals should be withdrawn and alternatives considered.

[10]Depository Trust & Clearing Corporation, DTCC Recommends Shortening the U.S. Trade Settlement Cycle, April 2014 (advocating for a move to a two-day settlement period).

[11]*Id* at 2.

Proposed Alternatives

We believe that the Proposals' efforts to improve the transparency of fixed income pricing information for retail investors while well intentioned fall short in a number of areas and should be withdrawn. In place of the Proposals, we recommend FINRA and the MSRB consider the following alternatives and modifications that we believe meet the same policy goals as put forth in the Proposals.

TRACE and EMMA. Retail customers can currently 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. The MSRB's Proposal would provide investors with information generally already publicly available on the MSRB's EMMA website but would provide it directly to investors in connection with their transactions. Given the significant amount of data already available to investors on TRACE and EMMA, FINRA and the MSRB should explore further using these existing price transparency sites as viable alternatives to the Proposals.

For example, we support greater opportunities for direct access to TRACE and EMMA by retail customers through their online brokerage account platforms, as well as through retail investor education efforts more generally. We believe that investors are more likely to use this information if it is readily available to them. For this reason, Fidelity already makes real-time trade reporting from FINRA TRACE and MSRB RTRS available on *Fidelity.com.*

We also believe that it would be fairly easy to provide CUSIP-specific links to EMMA and TRACE historical transaction data on customer confirmation statements. Currently, EMMA uses intuitive, retail customer-friendly hyperlinks to information on its website. For example, to obtain trade activity history for Massachusetts State GO Bonds Series 2009A, 4%, 3/1/2015 (CUSIP 57582PPT1), a retail customer could simply type the following hyperlink into their internet browser: emma.msrb.org/SecurityDetails/TradeActivity/57582PPT1. The only variable portion of the hyperlink text is the CUSIP number. FINRA could adopt a similar hyperlink protocol to allow retail customers to obtain TRACE trade activity for a particular security on its website. These hyperlinks could be printed on trade confirmation statements with a brief description of the information that can be found on the respective sites. We believe that this alternative approach would provide retail investors with far more price reference information than a single trade could provide, and can also help drive increased adoption of TRACE and EMMA by retail investors.

Shorten Time Horizon. FINRA notes that it "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."[12] Despite this data, the Proposals would apply to all retail-size principal trades executed on the same day as a customer trade. We believe that the Proposal's full day time

[12]FINRA Proposal at page 2

horizon is unnecessarily long and fails to consider that market conditions can significantly change over the course of a day that could impact pricing, *e.g.* severe market moves, increased volatility and limited liquidity.

If a new confirmation disclosure obligation with specific price references must use a "matched trade" concept, we believe the time horizon for this disclosure should be reduced. We believe that a majority of riskless principal transactions occur well within 15 minutes of each other. To better address the regulatory goal of increased price transparency in riskless principal transactions, if a "matched trade" concept must be used, FINRA and the MSRB should reduce the time window for matched trades from a full business day to 15 minutes.

Certain Aspects of the Proposals Must be Clarified

Although we believe that the Proposals should be withdrawn, if FINRA and the MSRB ultimately go forward with the Proposals, we recommend that certain aspects are clarified prior to final rulemaking.

Allocations

FINRA and MSRB should clarify that the determination of whether specific transactions are subject to the Proposals' disclosure requirements should be applied at the parent account level, not at the sub account level. Transactions with investment advisers in amounts exceeding any qualifying size or allocated to retail customers of the investment adviser, should not be subject to the proposed confirmation disclosure obligations. It would be enormously complex and potentially impossible for broker-dealers to allocate various portions of an institutional block trade into retail customers' respective components, particularly since investment adviser direction for allocations does not typically come to the clearing broker-dealer until the end of the business day. For example, a purchase of $500,000 face amount of a bond by an investment manager on behalf of advisory clients will be booked as allocated and confirmed at the sub account/end customer level, potentially as ten, $50,000 transactions at the end of the day. We believe that disclosures aimed at retail investors should not be required in this case because the investment adviser or other institution making the transaction decision has access to pricing information.

Affiliated Desks

FINRA and the MSRB should also clarify that trading by separate desks and affiliates is not subject to the disclosure requirements. Many broker-dealers employ a separate, specialized trading desk structure, where for example, one desk or group covers the firm's intermediary client trading, another is designated coverage for institutional accounts, and another trades solely on behalf of the firm's retail client accounts (or similarly, transactions for the intermediary, institutional, or retail accounts of a member firm's affiliate).

We believe that trading activity by separate trading desks and affiliates should not be matched. We do not believe that the disclosure of unrelated reference transactions by affiliates

and/or affiliated desks will be helpful to retail customers. Moreover, matching trading activity by separate trading desks and affiliates will significantly increase the complexity of implementation efforts for many broker-dealers who, by design, currently segregate or block this transactional information between desks/businesses.

* * * * *

Fidelity thanks FINRA and the MSRB for considering our comments. We would be pleased to provide any further information and respond to any questions that you may have.

Sincerely,

Norman L. Ashkenas
Chief Compliance Officer
Fidelity Brokerage Services, LLC

Richard J. O'Brien
Chief Compliance Officer
National Financial Services, LLC

cc:

Mr. Richard Ketchum, Chairman and Chief Executive Officer, FINRA
Ms. Susan Axelrod, Executive Vice President, Regulatory Operations, FINRA
Mr. Robert Colby, Chief Legal Officer, FINRA

Ms. Lynette Kelly, Executive Director, MSRB
Mr. John A. Bagley, Chief Market Structure Officer, MSRB
Mr. Michael L. Post, Deputy General Counsel, MSRB

Mr. Stephen Luparello, Director, Division of Trading and Markets, SEC
Mr. Gary Goldsholle, Deputy Director, Division of Trading and Markets, SEC
Mr. David Shillman, Associate Director, Division of Trading and Markets, SEC
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January 20, 2015

To: Ms. Cythia Friedlander
Director, Fixed Income Regulation
FINRA

By email to Pubcom@finra.org

Dear Ms. Friedlander:

In response to Regulatory Notice 14 – 52 ("Pricing Disclosure in the Fixed Income Markets"), we would like to submit the following comments.

It is our belief that the proposed rule would adversely affect both Municipal and corporate bond markets for "retail" and "institutional" participants. We understand the idea of protecting the customer and agree with the basis of providing best execution for all clients. However, we believe not only that this proposed rule is likely not the best solution, but additionally it may have adverse consequences which may be overlooked in the proposal. We are of the belief that if this rule is enacted, it may in fact cause loss of market makers, deteriorating liquidity in already somewhat illiquid markets, and consequently wider spreads in these markets. In an effort to protect the customer, this proposal may in fact provide for far worse execution. This could potentially be a side effect the authors of this proposal may be overlooking.

Increases in the costs of doing business, paired with increased risks and lower potential reward (or profit) from taking risk would likely push a number of market makers out of the market. More market maker participants translate directly to increased liquidity and competition, leading to tighter spreads and better execution. Declining market maker participation would translate directly to the opposite, decreasing liquidity and competition, and wider bid/ask spreads. Looking at municipal markets, market makers who cover less populous states are even more critical to meet the needs of customers in these states because these markets are overlooked by the larger institutional municipal bond dealers.

Direct costs related to this proposed rule are addressed within the Regulatory Notice and include the costs associated with creating customer confirmations which provide disclosure of pricing information. We believe the proposal may overlook potential indirect costs of providing additional compliance oversight to ensure proper compliance to a fairly complex rule. We already are required to have a trade by trade review which occurs the following day via trade blotter review. Additionally, the proposed rule may create pressures for market makers who are charging reasonable rates to decrease sales charges to stay competitive and could ultimately eliminate many market makers, who are critical to providing market liquidity. This potential for increased cost and risk, along with decreased potential reward could be a catalyst for declines in the number of market makers in both municipal and corporate bond markets.

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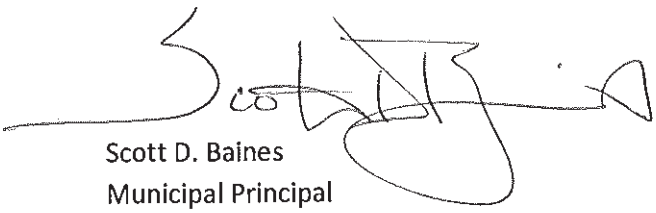
In examining the examples used in Regulatory Notice 14-52 we feel that example 6 displays that some regulatory confusion still exists within the bond markets and MSRB and Trace reporting. The example states, *"For Customer 2, Firm A would disclose the price to the firm (98), the price to the customer (102) and the differential between the two prices (4.00)."* In this scenario there would be sales credit of 2.00 percentage points on each side of the trade, leading to a price to the firm of (100) rather than (98). These are two separate and independent trades with reasonable sales credit of 2% being charged. We believe FINRA already has procedures in place for preventing excessive sales charges and if, as the example states, the firm were to charge 4%, there would be regulatory flags which would prompt further examination of the trade in question.

Perhaps a better alternative to the proposed rule may be to educate the investing public on customer protection safeguards already in place. Through better education, it may be feasible that FINRA is able to calm some retail customer concerns and provide some clarity to the retail customer on how the bond markets are structured, how the markets work efficiently under the current structure, and how FINRA is able to provide customer protection under current market structures.

Sincerely,



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We at Mutual Trust Co. Of America Securities, in Clearwater, Florida welcomes the opportunity to comment on 14-52.

What is worse than not enough information? Too much information! Give a plant some fertilizer, and it thrives. Pour a whole bucket of fertilizer on it, and it dies. In an effort to protect investors, regulators require that we give them prospectuses. Unfortunately, they are so complex that it takes an attorney to understand them. Complexity is slowly percolating into every crevice of the financial services industry. Are we barraging clients with so much information that they will soon be stultified into a state of indecision?

It is evident that regulators want uninformed investors to believe a false narrative. This false narrative states that higher expenses must be bad, while lower expenses must be good. Naturally, any sophisticated, wealthy investor knows otherwise, or there would not be hedge funds or professional money managers. Rule 14-52 is obviously geared towards the small, uninformed investor because of the size requirements. Its a false narrative, and its misleading uninformed small investors who are easily deceived. FINRA itself farms out its portfolio management to a professional money manager for a fee. A fee which a small investor which may find absurdly high!

I think we can all agree that if history has taught us anything, it has taught us that free markets and capitalism are always the best systems. If a markup is important to an investor, then an investor should be free to shop around for a firm that discloses whatever information is important to the investor. We do not need bureaucratic inflexible regulators disrupting the free flow of markets. And we do not need unbending intransigent regulators dictating to market participants what information needs to be disclosed and what information does not need to be disclosed. When free markets are meddled with by outside forces unintended consequences may surely follow. One of those may be that small investors, those who may require advice the most, may be relegated to self service accounts, or accounts with high maintenance fees. This new rule is ill advised.

Thank you for your consideration.

Jed Bandes, Clu, ChfC, CFP
President
Mutual Trust Co. Of America Securities

FINANCIAL SERVICES INSTITUTE

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 pricing[4] 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.

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[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

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[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.

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[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:

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[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

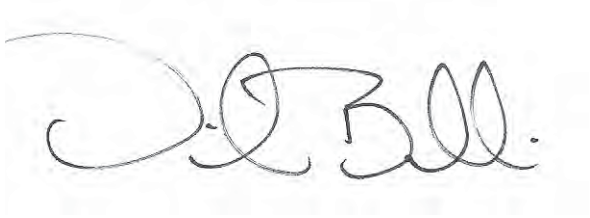
FSI also suggests that FINRA commit to exploring ways to establish centralized marketplaces for fixed income securities. True pricing transparency will only be established once the structures of the fixed income markets are altered. Market participants and regulators have recently addressed the possibility 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,



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.

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January 20, 2015

Via Email Only @ pubcom@finra.org

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

Re: **Regulatory Notice 14-52**
Proposed FINRA rule that would require firms to disclose additional information on customer confirmations for transactions in fixed income securities.

Dear Ms. Asquith:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by the Financial Industry Regulatory Authority ("FINRA") relating to both investor protection and disclosure.

FINRA has requested 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 for same-day, retail-size principal transactions in corporate or agency debt securities, 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.

While PIABA generally applauds any effort to provide more transparency in the securities trading arena, we believe the fixed income confirmation proposal as written is unnecessarily limiting. FINRA is 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. 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. 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.

The proposed rule only applies to trade confirmations for purchase or sale transactions of 100 bonds or less or bonds with a face value of $100,000 or less. We understand that FINRA studied these sorts of transactions in the third quarter of 2013 and found that 60% of the sales to customers had corresponding principal trades on the same trading day, with 88% of those events involving principal and customer trades occurring within thirty minutes of each other. Thus, while there are certainly a large number of customer orders being sourced from same-day principal transactions, PIABA does not see the rationale for the quantity/price boundaries and believes the rule should apply to *all* retail transactions. FINRA Rule 2232(a) cites SEA Rule 10b-10 for the requirement of what information must be disclosed in an equity trade confirmation. SEA Rule 10b-10 requires disclosure of the fee paid to the broker, whether the transaction is on an agency or principal basis.[1] The number of shares and dollar value of the equity security transactions are irrelevant under the rule requiring disclosure of the remuneration paid, and there is no valid reason that the size of a debt security transactions should be a trigger for a similar disclosure.

Further, PIABA would like to see fixed income trade confirmations disclose the actual markups/markdowns and not only for riskless transactions but for all fixed income retail transactions. As the rule stands now, the markup/markdown disclosure would be required *only* if there are corresponding trades on the same day. Regulatory Notice 14-52's example 13, for example, would not require disclosure where Firm A sold 100 XYZ bonds to its customer on Day 2, with those 50 of bonds having been sourced at 15:30:00 PM on Day 1 and 50 of them having been sourced at 10:00:00 AM on Day 2. PIABA would prefer that all of the pricing information be disclosed, regardless of whether the bonds sold to the customer were sourced on Day 1 or Day 2. However, at a bare minimum, pricing information should be provided for the 50 bonds that were sourced on Day 2 – the day on which the bonds were sold to the client. Absent such a requirement, there is a meaningful incentive for member firms to game the system by sourcing a single bond for each customer sale from old inventory, thereby avoiding entirely the need to disclose the markup/markdown.

Also, pricing should be disclosed in real time so all customers will have easy access to the markups and markdowns, not limited to the more sophisticated clients with access to advanced pricing data. The current system and the attendant lack of transparency opens the door for exploitation and abuse. Therefore, the disclosure of real time pricing and markups/markdowns for all retail fixed income transactions will ultimately benefit and protect the public retail investor, which protection is and always will be PIABA's primary goal.

Abuse of undisclosed markups and markdowns is not a hypothetical problem. The last few years have seen FINRA pursue a number of disciplinary actions against member firms concerning excessive markups and markdowns of debt instruments. For example, in 2012, FINRA fined Citi International Financial Services LLC $600,000 and ordered more than $648,000 in restitution and interest to more than 3,600 customers for

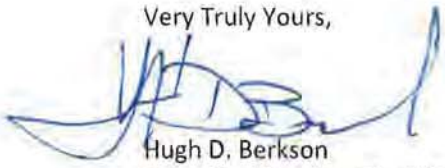
[1] *See* Rule 10b-10(a)(2)(i) and 10b-10(a)(2)(ii), noting that the fee paid need not be disclosed in an agency transaction if the fee paid is pursuant to a written agreement and is not on a per-transaction basis.

charging excessive markups and markdowns on corporate and agency bond transactions.[2] In 2013, FINRA fined StateTrust Investments, Inc. over $1 million for charging excessive markups and markdowns in corporate bond transactions and ordered the firm to pay more than $353,000 in restitution and interest to customers who received unfair prices. FINRA found that 85 of the transactions, in particular, operated as a fraud or deceit upon the customers.[3] Also in 2013, FINRA fined Morgan Stanley Smith Barney LLC and Morgan Stanley & Co. LLC $1 million and ordered $188,000 in restitution plus interest for failing to provide best execution in certain customer transactions involving corporate and agency bonds, and failing to provide a fair and reasonable price in certain customer transactions involving municipal bonds.[4]

Had the pricing information been available to the customers on the confirmations, perhaps the customers would have been charged fair prices. To be clear: PIABA supports the amendment to rule 2232 insomuch as it creates greater transparency in retail fixed income trading. However, PIABA requests the amendment not be limited to 100 bonds or a face value of $100,000 or less but apply to all retail fixed income transactions. There is nothing to indicate that unfair pricing or excessive markups and markdowns only occur when the size of the transaction is limited in size or the transaction is sourced from a same-day principal trade.

Thank you for the opportunity to comment on the rule proposal.

Very Truly Yours,



Hugh D. Berkson
Executive Vice-President/President-Elect, PIABA

[2] *See* http://www.finra.org/newsroom/newsreleases/2012/p125821.
[3] *See* http://www.finra.org/Newsroom/NewsReleases/2013/P288973.
[4] *See* http://www.finra.org/Newsroom/NewsReleases/2013/P317817.

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August 4, 2015

Ms. Maria E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006

RE: Comment Filing
FINRA NTM 14-52

Dear Ms. Asquith:

Please allow me to start by saying that Capital Investment Group, Inc.'s (CIG) believes that transparency is paramount to the success of our industry. We value our customers and consider it an honor to not only educate, but assist our customers in their financial management needs.

With that said, as a member subject to the proposal outlined in FINRA Notice to Members (NTM) 14-52, CIG is greatly concerned with the rule package proposal as outlined below.

Consistency

Currently, FINRA rules require broker-dealers to disclose mark ups and mark downs on confirmation statements that pertain to equity trades. These figures are denoted in a fractional denomination that is associated with the principal transaction amount and appears in the memorandum line of the confirmation. The rule proposal, as outlined in NTM 14-52, suggests that firms will be required to identify the actual dollar value of any mark up, or mark down, and the differential amount between the price paid by the broker-dealer to that of the customer. This differs from the previous practice, thus potentially causing confusion to customers.

Disclosure

CIG is concerned with the effectiveness of further disclosure. Again, we are sympathetic to the regulatory initiative of transparency. To-date, we believe that such systems like TRACE and other real-time market databases provides for quick, reliable information about market conditions for point of sale transactions. We do, however, remain concerned that over-disclosure to the retail investor may not suffice the initiative of transparency. Furthermore, the question exists whether such disclosure is necessary for sophisticated and/or institutional investors. Aside from that, particularly with retail investors, it is quite conceivable that confusion will be created for clients due to the multiple prices being listed; especially when multiple trading necessitates the need for weighted average pricing, the computation, differences between price points, etc...In addition to this, other factors such as the

positioning of these disclosures and logistically identifying variables between fractional and nominal denominations creates further concern; especially from costs that likely will grow to be very restrictive.

Costs

CIG definitely is concerned with increasing costs as a result of implementation of the regulations as proposed. In order to foster effective implementation, and ongoing processes, these regulations are very likely to create electronic infrastructural changes for firms; especially those firms like our clearing agent and full-service clearing broker dealers. Currently, we are not aware that systems utilized today have the capability or capacity required for this type of change. It is our opinion that augmentation of computer systems will likely occur; thus requiring further costs associated with such changes to be assessed on firms like ours, which ultimately transmits to our customers.

Staffing Concerns

The new rule, as proposed, will impose burdensome requirements for FINRA members that are smaller in size. Not to discredit the need for stringent reviews of transaction activity, but the level of detailed review required to identify whether transactions are subject to the proposed regulations creates onerous demands of the staff. Hiring additional staff is likely to result in addition to acquiring further technology. However, as previously referenced, the potential for high costs associated with implementing electronic resources, or augmentation to those systems in place, make for difficulty with implementation of the proposed regulation.

In conclusion, transparency of information and having informed customers is paramount. However, attempting to do so to the point that we may create conflict or become detrimental to the cause is not wise. Unfortunately, we feel that implementation of this proposal, as outlined in NTM 14-52, will do just that without deriving overwhelming benefit for our customers. Our customers need to be informed and they need to understand what is occurring at the point of sale. It is this effort that we work diligently to preserve and improve upon so that the service we provide is beneficial for all.

We thank you for the opportunity to provide comments and remain committed to providing further assistance.

Sincerely,

Richard Bryant
President

VIA EMAIL: pubcom@finra.org

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January 20, 2015

VIA ELECTRONIC MAIL

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: **MSRB Regulatory Notice 2014-20, Pricing Reference Information on Retail Customer Confirmations**

Dear Mr. Smith:

Thank you for the opportunity to submit comments on the draft rule amendments requiring the disclosure of a "reference transaction" price on customer confirmations for retail-size principal transactions. Hutchinson, Shockey, Erley & Co. (HSE) is an investment bank and broker-dealer that specializes exclusively in municipal securities, and has done so since the firm's establishment in 1957. As such, we believe we are well-positioned to provide comments on the draft rule amendments and we are pleased to do so.

As a general principal, HSE supports increased price transparency for retail investors in the municipal securities market. Our firm transacts municipal securities business only with Sophisticated Municipal Market Professionals, however, and therefore our comments will focus specifically upon the following question for which the MSRB has sought feedback:

Is it appropriate to provide that a dealer is only obligated to disclose pricing reference information when the customer trade is likely to be a retail trade? If so, should retail be defined by reference to the trade size, as in the proposal, or by some other standard?

HSE feels strongly that any obligation to provide pricing reference information should be limited to retail trades. It would be unnecessary for broker-dealers to disclose the pricing of "reference transactions" on trade confirmations for Sophisticated Municipal Market Professionals, as SMMPs have access to the same sources of pricing information as broker-dealers do. Moreover,

SMMPs have the knowledge of how to use these information sources, and the timeliness of the SMMP's access is on par with that of the broker-dealer. Indeed, in our experience, an SMMP's decision to execute a transaction is typically based upon his awareness and understanding of contemporaneous transactions in the same or similar municipal securities.

Because the SMMP has timely access to the same sources of pricing information as the broker-dealer, and because the SMMP has the specialized knowledge and experience to understand the meaning of that pricing information, it is unnecessary for the pricing of "reference transactions" to be disclosed on trade confirmations for SMMPs. Therefore, for purposes of the draft rule amendments, "retail" should not be defined by trade size, but rather on the basis of whether or not the customer meets the definition of SMMP. The somewhat arbitrary, though oft-cited, transaction size of 100 bonds as the defining line between retail and professional is inappropriate here. Using trade size as the standard for application of the draft rule will certainly result in less-than-complete coverage of retail market participants; it will also result in the capture of a significant number of transactions with SMMPs.

By way of example: in December 2014, HSE – which, again, conducts its business exclusively with SMMPs – wrote 1,999 trade tickets in transactions involving 728,565,000 bonds. The average trade size was 365 bonds. The smallest trade size was 5 bonds; the largest was 8,080,000 bonds. **Of the 1,999 trade tickets, 959 of them represented trades of 100 or fewer bonds.** Fully 48% of our transactions in the month – all of which were executed with SMMPs – would be subject to reference pricing disclosure under the retail standard proposed in the draft rule amendments. To conform to the stated purpose of providing increased transparency to retail investors, the standard by which retail is defined in the draft rule amendments must be changed; if it is not, the result will be considerable unnecessary reporting and additional unwarranted burdens on the broker-dealer community. The MSRB already employs a standard by which retail is separated from non-retail, and that standard is the SMMP.

On behalf of Hutchinson, Shockey, Erley & Co., I thank you for your consideration of these comments.

Sincerely,

Thomas E. Dannenberg
President & CEO

cc: Marcia Asquith, Office of the Corporate Secretary, Financial Industry Regulatory Authority

sifma
Invested in America

January 20, 2015

BY ELECTRONIC MAIL

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

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

MSRB Regulatory Notice 2014-20,
Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations

Dear Ms. Asquith and Mr. Smith:

The Securities Industry and Financial Markets Association[1] ("SIFMA") appreciates the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA's") Regulatory Notice 14-52 and the Municipal Securities Rulemaking Board's ("MSRB's") Regulatory Notice 2014-20 (together the "Matched Trade Proposals" or the "Proposals"). SIFMA strongly supports efforts to enhance bond market price transparency in a carefully calibrated manner that strikes the right balance in pursuing desired goals while minimizing unintended consequences. However, because the enormous costs and burdens associated with the Proposals would significantly outweigh the purported benefits, SIFMA urges that the Proposals be withdrawn in favor of an approach that encourages increased usage of the extensive pricing data already available on the existing Trade Reporting and Compliance Engine ("TRACE") and Electronic Municipal Market Access ("EMMA") systems.

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

INTRODUCTION AND SUMMARY

The Matched Trade Proposals seek to enhance fixed income price transparency by putting more information into the hands of retail investors in fixed income securities. SIFMA fully embraces this objective. Unfortunately, the Proposals fail to leverage the very tools that have led to unprecedented improvement in fixed income price transparency: the price dissemination systems operated by FINRA and the MSRB. As the SEC predicted at the time of their development, the TRACE and EMMA systems currently "provide better market information to investors on a timely basis (e.g., before the transaction)" than approaches that "focus[] on only one portion of the market," i.e., riskless principal transactions. The Proposals' reliance on confirmation disclosure concepts is misplaced. FINRA and the MSRB should instead focus on increasing usage of the abundance of market data made available through TRACE and EMMA. The Matched Trade Proposals would provide inferior disclosure, to fewer investors, while imposing unjustified costs and burdens than alternatives that increase TRACE and EMMA usage. Moreover, the Proposals fail to adopt a uniform approach and terminology, inviting additional costs and burdens if they are administered differently.

SIFMA's views on the Matched Trade Proposals are summarized as follows:

- ***SIFMA believes that the Matched Trade Proposals should be withdrawn and replaced with disclosures that encourage increased usage of bond pricing data and investor tools already on the TRACE and EMMA platforms.*** SIFMA urges FINRA and the MSRB to withdraw the Matched Trade Proposals in favor of an approach that furthers the shared objective of increasing fixed income price transparency by increasing investor usage and reliance on TRACE and EMMA. Specifically, SIFMA supports adding additional disclosure for retail customers on confirmation backers for TRACE and EMMA transactions providing explanatory information about the availability of comparative CUSIP-specific transaction data – together with pointers or hyperlinks to the relevant FINRA and MSRB webpages. SIFMA supports making periodic disclosure about the availability of pricing data and public user accounts through TRACE and EMMA in connection with account opening and customer statements. SIFMA also supports greater opportunities for direct access to TRACE and EMMA by retail customers through their online brokerage account platforms, as well as retail investor education efforts more generally. In short, FINRA and the MSRB should promote TRACE and EMMA as the solution for increased transparency, using the power of the internet to reach the ever-increasing portion of retail investors who rely on it on a daily basis for communications and commerce of every sort.

  The confirmation disclosure obligation set forth in the Proposals has a storied past. Some form of it has been entertained and rejected by the SEC on at least four occasions since 1978. On each occasion, the significant costs, burdens, and expenses it would have imposed were determined to fail cost-benefit assessments,

leading the SEC to pursue less costly (and more effective) alternatives. (Part I.A.) The alternatives that were pursued – the current TRACE and EMMA platforms operated by FINRA and the MSRB – have dramatically improved price transparency for the bond markets and continue to evolve. They were funded, and continue to be funded, by tens of millions of dollars in transaction fees every year and are resourced on an ongoing basis by the bond dealer community. (Part I.B.) Since 1994, FINRA, the MSRB, and the SEC have embraced these platforms as the primary vehicles for enhancing bond market price transparency. (Part I.C.) At a time when internet usage by American investors is at an all-time high, with mobile internet access ubiquitous, the Proposals are regrettably backward-looking, more costly, and inferior to existing forms of post-trade transparency. Rather than denigrate and circumvent their utilities, FINRA and the MSRB should explore ways to increase their everyday use by investors. (Part I.D.)

- ***SIFMA objects to the Matched Trade Proposals because they risk confusing retail investors, present unworkable challenges in application, and threaten burdensome operational challenges that would dwarf any claimed benefits***. The Proposals would mandate new disclosure that would be inherently confusing to retail investors. They would introduce the concept of a "reference transaction" – a term that is without meaning to retail customers in form or substance and is not readily determinable. Customers would understandably mistake the disclosure for a bond's prevailing market price and the corresponding mark-up – terms that do have meaning to them. The disclosure would do nothing to advance investor understanding of the market activity in their bonds more generally and – by artificially matching unrelated trades occurring potentially hours apart – actually threatens to mislead investors about the quality of execution.

  The many problems confronting the Proposals lead SIFMA to conclude that the Proposals are unworkable as constructed:

  - Investors will be misled as to dealer compensation. The Proposals present a substantial risk of confusing the very group of retail investors that the new disclosure was intended to help. Neither the nature of the proposed reference price nor its occasional appearance would be capable of summary description. The price differential disclosure would be confused with dealer compensation. But when intervening developments cause a bond's price to move on an intraday basis, or when the "matched" trades are entirely unrelated (as described below), the figure reflects market movement or merely the happenstance of a separately-negotiated transaction. (Part II.A.)

  - Investors will be misled by negative price differentials. The Proposals do not address the potential for confusion when the price differential would be a negative figure, or even whether a negative figure ought to be disclosed. (Part II.B.)

- Trading by separate desks and affiliates is not envisioned by the Proposals. The Proposals do not seem to contemplate that dealers' institutional, retail, and proprietary trading desks may operate independently, whether by formal separation or simply as separate businesses, complicating whether and how transactions would or should be matched across these desks. Certain dealers operate these different bond trading operations as separate legal entities, using different execution and clearance platforms, calling into question the feasibility of design and implementation. (Part II.C.)

- The Proposals conflict with rules governing new issue disclosures. The Proposals threaten confusion in the market for new issues of debt securities by potentially introducing disclosure that would conflict with FINRA and MSRB mandated underwriting compensation and fee disclosures. (Part II.D.)

- The Proposals ignore size as a pricing consideration. Unlike other proposals addressing fixed income pricing, the Proposals ignore the potential differences in pricing between retail and institutional-sized transactions. (Part II.E.)

- The Proposals are overbroad and would apply to trades with institutional and other sophisticated investors. Although the Proposals profess an objective to limit the proposed disclosure to retail customers, the threshold used for this obligation is too high and overbroad because it will include many trades with institutional and other sophisticated investors. (Part II.F.)

- The Proposals present enormous operational challenges. The Proposals present potentially insurmountable operational challenges, in large part because they ignore the complexity created by a convoluted matching mechanism and are not limited in application in the same manner as prior SEC proposals. Even so limited, the challenges and costs associated with the Proposals would be enormous. (Part II.G.)

- ***SIFMA believes that – if FINRA and the MSRB were to require a new confirmation disclosure obligation with specific price references – a number of critical changes must be made to minimize the risk of investor confusion and to mitigate the unnecessary implementation challenges.*** SIFMA does not believe that the approach taken by the Proposals is advisable or workable, and further believes that retail investors would be better served by greater use and reliance on pricing data currently available free of charge on TRACE and EMMA. But if some form of the Proposals does proceed, it should be more carefully tailored to avoid investor confusion by limiting the confirmation disclosure to riskless principal transactions involving retail customers. Additional clarifying changes are also needed to mitigate the excessive burdens and costs associated with the current formulation. Necessary changes include:

- The FINRA and MSRB Proposals must be uniform in design and terminology. Despite an effort to be uniform, the Proposals use different terms, phrases, and structure. In the context of the Proposals, there is no policy justification for having divergent approaches or terminology. Unnecessary differences in formulation invite unintended costs and burdens if (and all too often as) they are administered differently. (Part III.A.)

- Any retail confirmation disclosure with specific price references should apply solely to trades in which no market risk attaches to the dealer effecting the transaction ("riskless principal transactions"). Any retail confirmation disclosure obligation with specific price references should apply only to riskless principal transactions to avoid investor confusion and to ensure greater consistency with current obligations for equity transactions. While still very much a distant "second best" alternative to steering investors to the breadth of pricing information available on TRACE and EMMA and one that would still impose many of the high costs and burdens of the Proposals – such an approach would be much more aligned with the stated objective of the Proposals to provide information about dealer compensation. (Part III.B.)

- Riskless principal transactions should be classified using the established definition. Any new confirmation disclosure with specific price references should use established and clear terms, capable of concise explanation and easily understood by investors and dealers alike. (Part III.B)

- Any confirmation disclosure obligation with specific price references should be better tailored to retail trades and investors by using defined terms to exclude institutional and other sophisticated investors and more appropriate quantity thresholds. The "qualifying size" for transactions ought to be set at $99,999 face amount or less to avoid the many institutional transactions that involve face amounts of $100,000. In addition, consistent with the stated policy objectives of the Proposals, any new disclosure obligation with specific price references ought not to apply to institutional or other sophisticated customers as defined by existing FINRA Rule 4512(c) and MSRB Rule G-8(a)(xi) (defining "institutional account"), as well as Investment Company Act Section 2(a)(51) (defining "qualified purchaser"). (Part III.C.)

- Trading activity by separate trading desks and affiliates should not be matched. Should a confirmation disclosure obligation with specific price references not be limited to riskless principal transactions, any matching methodology should apply only to those trades executed by a member's retail desk. (Part III.D.)

- Less burdensome price reference disclosures should be allowed. For dealers that utilize standard mark-up or sales credit schedules, any

confirmation disclosure obligation with specific price references should be satisfied through disclosure of the schedule or the specified compensation figure. (Part III.E.)

- Any new confirmation requirement should not require confirmations to be canceled and corrected due solely to a change in the reference transaction price. (Part III.F.)

- ***SIFMA objects to the inadequacy of the cost-benefit analyses undertaken by FINRA and the MSRB.*** Nothing in the Proposals suggests that FINRA or the MSRB has even begun to compile a record – as required under federal law and their own policies – that would either permit an informed analysis of the costs and benefits presented by the Proposals or allow an appropriate review by the SEC. Nor do the Proposals even purport to comply with federal laws governing new recordkeeping requirements or burdens on small businesses. (Part IV.A.) There has been no apparent consideration – quantified or otherwise – of other alternatives including making better use of TRACE or EMMA to achieve some or all of the regulatory objective. Given longstanding policy to use these platforms as the primary mechanism for enhancements to bond market transparency, the costs associated with their development and maintenance must be considered in connection with the Proposals. The Proposals fail to provide sufficient justification for a departure from previous conclusions to invest in these platforms rather than pursue costly additional disclosure obligations. (Part IV.B.) Finally, based on assessments SIFMA has gathered on its own, the implementation costs would be enormous and simply cannot be justified on the basis of the aspirational, speculative benefits described in the Proposals. (Part IV.C.)

DISCUSSION

I. FINRA AND THE MSRB SHOULD CONTINUE TO EMBRACE AND ENHANCE TRACE, EMMA, AND OTHER REAL TIME ELECTRONIC TRANSPARENCY INITIATIVES, RATHER THAN IMPOSE NEW (AND LESS EFFECTIVE) PRICE REFERENCE CONFIRMATION DISCLOSURE OBLIGATIONS.

A. The SEC, FINRA, and the MSRB Have Repeatedly Found that Confirmation Disclosure of the Sort Currently Proposed Is More Costly and Inferior to Alternative Forms of Post-Trade Transparency.

The SEC – citing concerns based on cost-benefit analyses – previously considered and rejected similar confirmation proposals on no less than four prior occasions. Ultimately, the SEC endorsed the development of electronic transparency platforms such as TRACE and EMMA over confirmation disclosure, finding that the price dissemination platforms would provide superior and more meaningful investor benefits.

The first SEC proposal to require disclosure of mark-ups on riskless principal transactions in municipal and corporate debt securities was deferred in large part because of concerns that the costs would outweigh the benefit, especially as to municipal bond investments.[2] In particular, the MSRB urged the Commission to consider whether such disclosure requirement was necessary in view of a proposed MSRB confirmation rule.[3] Deferring to the MSRB, the Commission ultimately withdrew its proposal with respect to transactions in municipal securities.

The second SEC proposal to require disclosure of mark-ups on riskless principal transactions in municipal and corporate debt securities was again deferred based on the policy views of the MSRB.[4] Citing the MSRB's conclusion that "the imposition of a requirement to disclose remuneration in principal transactions in municipal securities is unnecessary and inappropriate," the Commission decided to re-propose the requirement to gather additional public comment from bond market investors and participants.[5]

The third SEC proposal,[6] which was singularly focused on the disclosure of mark-ups on riskless principal transactions in bonds, was withdrawn after commenters – including the MSRB – stated their view that it "failed to take into account the substantial differences between the markets for debt and equity securities" and "imposed an unreasonable burden on small broker-dealers."[7] The withdrawal notice stated the SEC's conclusion that the proposal would not achieve its purpose "at an acceptable cost and that there are alternative ways of achieving the same goal with fewer adverse side effects."[8]

Most recently, in 1994, the SEC again considered and rejected confirmation disclosure of mark-ups on riskless principal transactions in corporate and municipal bonds.[9] Once again, the SEC concluded that price transparency initiatives underway

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[2] Securities Confirmations, Exchange Act Rel. No. 12806, 41 Fed. Reg. 41,432 (Sept. 22, 1976) (proposing release).

[3] Securities Confirmations, Exchange Act Rel. No. 13508, 42 Fed. Reg. 25,318, 25,319 (May 17, 1977) (adopting release).

[4] Securities Confirmations, Exchange Act Rel. No. 13661, 42 Fed. Reg. 33,348 (June 30, 1977) (proposing release).

[5] Securities Confirmations, Exchange Act Rel. No. 15219, 43 Fed. Reg. 47,499, 47,500 (Oct. 16, 1978) (final rule; rule; rule rescission) (quoting MSRB letter of Feb. 10, 1978).

[6] Securities Confirmations, Exchange Act Rel. No. 15220, 43 Fed. Reg. 47,538 (Oct. 16, 1978) (proposing release).

[7] Securities Confirmations, Exchange Act Rel. No. 18987, 47 Fed. Reg. 37,919, 37,920 (Aug. 27, 1982) (withdrawing release).

[8] *Id*.

[9] Confirmation of Transactions, Exchange Act Rel. No. 33743, 59 Fed. Reg. 12,767 (Mar. 17, 1994).

by FINRA and the MSRB – specifically referencing the predecessor to TRACE and a "developmental" version of EMMA – promised "more meaningful benefits to investors in the long-term" about a larger portion of the market than the proposed confirmation disclosure.[10]

The SEC's decision to withdraw the proposal was explicitly conditioned on the development by FINRA and the MSRB, with the support of the dealer community, of platforms that would provide greater price transparency for retail investors. The SEC viewed these price transparency platforms as a better, more effective alternative to confirmation disclosure. In reaching this determination, the Commission concluded that the proposed price information systems would provide superior investor benefits than the proposed mark-up disclosure:

> The Commission has deferred adoption of the riskless principal mark-up disclosure proposal in order to ascertain whether the proposed price information systems can provide more meaningful benefits to investors in the long-term and to assess the progress of the industry in developing the proposed systems. Price transparency, if fully developed, will provide better market information to investors on a timely basis (e.g., before the transaction). . . . The proposed mark-up disclosure, on the other hand, would have provided cost information to investors only in riskless principal transactions and would not have applied to other principal transactions, the majority of transactions in the debt market. Price transparency, if fully developed, meets investors' need for information without focusing on only one portion of the market . . . . The Commission recognizes that these benefits depend on the sound design and successful implementation of transparency proposals. . . . In the absence of progress on transparency, the Commission will revisit its riskless principal proposal.[11]

The Commission's policy choice was clear and informed: electronic post-trade price dissemination would bring "more meaningful benefits to investors" than piecemeal mark-up disclosure on riskless principal transactions. This choice – made at a time when the internet was in its infancy – recognized that the utility of confirmation disclosure must be assessed against the alternatives made possible by electronic transparency platforms.

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[10] Confirmation of Transactions, Exchange Act Rel. No. 34962, 59 Fed. Reg. 59,612, 59,616 (Nov. 17, 1994).

[11] *Id*.

Since the last consideration of some variant of the current confirmation proposal in 1994, there have been tremendous – indeed previously unimaginable – improvements in post-trade price transparency, coinciding with the explosive growth in internet access over the last two decades. Current and contemplated pricing transparency in TRACE and EMMA makes pricing information available to retail bond investors far more meaningful than anything under consideration in the confirmation disclosure proposals, all at the click of a mouse or swipe of a finger. Until now, at no point since 1994 – in spite of several dozen rulemakings addressing transaction reporting and dissemination and twenty years of published priorities – has the SEC expressed dissatisfaction with the transparency afforded by TRACE and EMMA. Similarly, FINRA and the MSRB have never before questioned the utility of TRACE and EMMA, despite statements in the Proposals questioning retail bond investors' usage and knowledge of these systems. As discussed in Part I.D, enhancing retail investors' use of TRACE and EMMA would result in greater post-trade price transparency at significantly lower cost than the Proposals.

B. The Policy Choice Made by the SEC, FINRA, and the MSRB To Fund and Construct Internet-Based Transparency Platforms To Reduce Informational Disparity Was Sound, Is Working Well, and Should Be Embraced.

Since 1994, FINRA and the MSRB have dramatically increased the information available to retail investors and the market generally about the prices of municipal and corporate bond transactions. The progress has been substantial. Over the course of two decades, retail bond investors have gained unprecedented access on a near-real time basis to prices of secondary transactions in corporate and municipal bonds across nearly every product class – far exceeding the SEC's expectation. The development and efficacy of these transparency platforms are directly relevant to whether – as proposed – a transaction confirmation approach to price transparency is warranted. As the MSRB itself acknowledged:

> Significant advances in the fixed income markets have helped to improve price transparency since the SEC's rulemaking efforts. Indeed, the SEC deferred consideration of its 1994 markup disclosure proposal due, in large part, to the planned development of systems that would make publicly available pricing information for municipal transactions.[12]

Indeed, the SEC's 2012 Report on the Municipal Securities Market ("SEC Municipal Report") also observed that "there have been significant improvements in recent years in the area of post-trade transparency," and that "[t]ransaction data can be accessed by the public free-of-charge through MSRB's EMMA website."[13] FINRA's TRACE

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12 MSRB Regulatory Notice at 5.

13 U.S. Securities and Exchange Commission, Report on the Municipal Securities Market

platform also "now provides investors with access to bond transaction and price information free of charge and on a near real-time basis for a significant portion of U.S. corporate bond market activity."[14]

Consistent with the explosion of electronic access made available with the internet, retail bond investors today have access to an increasing amount of information at no cost to them at speeds and in ways unimaginable in 1994. Rapid growth in internet access and penetration over the past two decades has paralleled the development and continued enhancement of TRACE and EMMA. In 1995, shortly after the SEC endorsed the development of price information systems, only 14 percent of American adults used the internet; by 2014, that number had increased to 87 percent.[15] The SEC recognized the transformative power of the internet more than 15 years ago, noting in a 1999 report that online-brokerage had caused "one of the biggest shifts in individual investors' relationships with their brokers since the invention of the telephone," and that "[f]or the first time ever, investors can – from the comfort of their own homes – access a wealth of financial information on the same terms as market professionals, including breaking news developments and market data."[16] Five years ago, an SEC survey found that 56 percent of investors rely on the internet in making investment decisions.[17] Inconceivable in 1994, today any retail investor with an internet connection has free access to information about corporate and municipal bond transaction prices that was previously unavailable even to professionals and regulators.

Today's TRACE and EMMA platforms are the result of more than twenty years of continued and incremental enhancements to corporate and municipal bond transaction reporting systems. The Fixed Income Pricing System (FIPS), the precursor

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(July 31, 2012) at 117 ("Data is searchable on EMMA and includes: trade date and time; security description and CUSIP number; maturity date; interest rate; price; yield; trade amount; trade type (i.e., customer bought, customer sold, or interdealer); and credit rating by S&P and Fitch, if available.") [hereinafter SEC Municipal Report].

[14] Commissioner Daniel M. Gallagher, Remarks at Municipal Securities Rulemaking Board's 1st Annual Municipal Securities Regulator Summit, Washington, DC (May 29, 2014). *See also* Commissioner Michael S. Piwowar, Remarks at the 2014 Municipal Finance Conference presented by The Bond Buyer and Brandeis International Business School, Boston, Massachusetts (Aug. 1, 2014) (noting that, "[i]n recent years . . . strides have been made to increase post-trade transparency for municipal securities through [EMMA]," which "now provides a wealth of historical pricing information in the municipal securities market in an easy to access format.").

[15] Pew Research Internet Project, Internet Use Over Time, http://www.pewinternet.org/data-trend/internet-use/internet-use-over-time/ (last visited Dec. 14, 2014).

[16] U.S. Securities and Exchange Commission, Online Brokerage: Keeping Apace of Cyberspace (Nov. 1999), *available at* http://www.sec.gov/pdf/cybrtrnd.pdf.

[17] Investment Company Act. Rel. No. 28584, 74 Fed. Reg. 4,546, 4,560 n. 195 (Jan. 26, 2009).

to TRACE, began operation in 1994 and required reporting transactions in certain high-yield bonds. FINRA launched TRACE in 2002 to disseminate pricing information across the broader corporate bond market. Public dissemination of transaction information was expanded in phases to allow FINRA to study the impact of transparency on liquidity. Today, transactions across an expanding range of eligible securities generally must be reported to TRACE within fifteen minutes; this information, in turn, is disseminated immediately for those securities subject to dissemination.[18]

With respect to the municipal securities market, the MSRB began disseminating transaction price information through the Transaction Reporting System (TRS) subscription service in 1995.[19] Following a series of scheduled improvements, TRS was replaced in 2005 by the Real-time Transaction Reporting System (RTRS), which disseminated transaction price information for most trades in municipal securities through an automated, real-time feed.[20] The launch of the EMMA website in 2008 "put timely market information directly at the fingertips of retail investors" for free.[21] The MSRB has continually sought to improve and enhance EMMA, most recently through the launch of a new "price discovery tool" that permits investors "to more easily find and compare trade prices of municipal securities with similar characteristics."[22]

The resources devoted to make the TRACE and EMMA platforms robust and widely available have been substantial. Accordingly, the benefits to retail bond investors gained from transparency enhancements have come at a significant cost. Launched in 2002, TRACE expenses exceeded $12 million for the first twelve months of operation.[23] By 2013, FINRA was expending nearly all of the $58 million it collected in relevant fees to support the TRACE platform.[24] From 2009 to 2014, the MSRB spent more than $76 million on market information transparency programs and operations, including its real-time transaction reporting service available on EMMA.[25]

In addition to supporting these transparency platforms through transaction fees, member firms have had to build out and implement systems necessary to populate data

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18 FINRA, TRACE Fact Book 2013, at 4.

19 MSRB, Long-Range Plan for Market Transparency Products (Jan. 27, 2012) at 16.

20 *Id* at 17.

21 MSRB, 2008 Fact Book, at 1.

22 MSRB Regulatory Notice at 5-6.

23 Exchange Act Rel. No. 49086, 69 Fed. Reg. 3416 (Jan. 23, 2004).

24 FINRA, 2013 Year in Review and Annual Financial Report.

25 MSRB, 2014 Annual Report; MSRB, 2013 Annual Report; MSRB, 2012 Annual Report; MSRB, 2011 Annual Report; MSRB, 2010 Annual Report; MSRB, 2009 Annual Report.

fields for TRACE and EMMA. At every stage of the development of price transparency initiatives on the TRACE and EMMA platforms – including expansion to various product classes and enhancements to dissemination practices – FINRA and the MSRB have justified the costs to member firms based on comparisons to, among other things, alternative disclosures of the type currently proposed. These costs have included considerable front- and back-end build-outs necessary to capture and report transaction information, ongoing system maintenance, enhancements to supervisory and compliance procedures and reviews, regulatory oversight of TRACE and EMMA obligations, and training. Notably, such costs are not limited to one-time implementation system build-outs; there are substantial and continuing costs associated with ATS reporting, tagging particular transaction types (e.g., affiliated transactions), and accounts (e.g., fee-based accounts). Some member firms have already provided links or data from TRACE and EMMA directly to retail customers on their electronic brokerage platforms. The industry, through SIFMA, has historically funded and supported a number of investor education initiatives and resources.

C. The TRACE and EMMA Platforms Provide More Information About Corporate and Municipal Bond Transactions and Pricing – At No Cost to Retail Investors – Than Ever Before, Far Exceeding What Was Historically Available to Dealers and Institutional Investors.

The amount of post-transaction information available on TRACE and EMMA is substantial and growing. Introduced in July 2002, TRACE "helps create a level playing field for all market participants by providing comprehensive, real-time access to public bond price information," and since March 2010, for U.S. agency debentures.[26] Following years of incremental expansions, the number of TRACE-eligible securities "increased from 37,000 in 2007 to 1.4 million in 2012."[27] In May 2011, TRACE began collecting transactions in asset-based and mortgage-based securities, with transactions in agency pass-through mortgage-backed securities traded to be announced (TBA transactions) currently subject to dissemination.[28] In July 2013, TRACE began dissemination of specified pool transactions in mortgage-backed securities.[29] Launched in 2009, the EMMA website provides free access to "official disclosure documents, trade prices and yields, market statistics and more about virtually all municipal securities."[30] Associated market transparency products include the EMMA Primary Market Disclosure Service, the EMMA Continuing Disclosure Service, the EMMA Trade Price Transparency Service, the Short-term Obligation Rate Transparency (SHORT) System, and the MSRB's municipal market research

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26 FINRA, TRACE Fact Book 2013 at 2.

27 Press Release, FINRA, FINRA Marks Fifth Anniversary, July 30, 2012.

28 FINRA, TRACE Fact Book 2013 at 2.

29 *Id.*

30 MSRB Regulatory Notice at 5.

services.[31]

The SEC, FINRA, and the MSRB have historically recognized that retail bond investors are best served by having access to the breadth and depth of pricing information available on TRACE and EMMA. Notwithstanding statements in the Proposals criticizing retail bond investors' ability to use or their knowledge of TRACE and EMMA, FINRA and the MSRB have never before questioned the utility of these platforms. On the contrary, FINRA and the MSRB have consistently – and appropriately – characterized TRACE and EMMA as major advances that brought unprecedented transparency to the corporate and municipal bond markets. In 2005, the NASD said that full implementation of TRACE "may be the most significant innovation benefiting retail bond investors in decades."[32] In 2008, the MSRB said that EMMA "put timely market information directly at the fingertips of retail investors" and "vastly improved on the information that retail investors could readily obtain."[33] In 2012, FINRA noted that TRACE is "providing unprecedented transparency to market participants and data to FINRA for effective regulatory oversight," as well as "saving investors an estimated $1 billion per year" through reduced transaction costs.[34] In 2013, the MSRB recognized that EMMA "has brought transparency of the municipal market to new levels."[35] In 2014, the MSRB described EMMA as "perhaps its single greatest contribution to the municipal market," referring to the EMMA website as "an indispensable resource for the market, with interactive tools to help users understand municipal trade prices."[36]

Given the magnitude of information available to retail investors for free on TRACE and EMMA, any perceived problems with investors using these systems should be addressed directly rather than mandating trade-specific confirmation disclosure. If there are issues to address, efforts would be better directed at encouraging and directing investors to use this information and potentially making the platforms even more user-friendly rather than deemphasizing their use. Indeed, FINRA and the MSRB both suggest that some retail investors are unwilling to access, or are simply unaware, of the extensive information available on TRACE and EMMA. FINRA acknowledges that "[a]lthough knowledgeable industrious customers could observe [principal and customer trades] retrospectively using TRACE data, . . . retail customers do not typically consult TRACE data."[37] For example, the MSRB suggests

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31 MSRB, Long-Range Plan for Market Transparency Products (Jan. 27, 2012) at 2.

32 Press Release, NASD, NASD's Fully Implemented "TRACE" Brings Unprecedented Transparency to Corporate Bond Market, Feb. 7, 2005.

33 MSRB, 2008 Fact Book at 1.

34 Press Release, FINRA, FINRA Marks Fifth Anniversary, July 30, 2012.

35 MSRB, 2013 Annual Report at II.

36 MSRB, 2014 Annual Report at 9.

37 FINRA Regulatory Notice at 2.

that the Proposal could benefit primarily those retail customers "who do not actively seek out [pricing] information, *including those who may not know of EMMA* or may not have the time or wherewithal to conduct their own transaction research" (emphasis added).[38] This sentiment undermines the basic principle that the MSRB built EMMA with the "specific aim of serving the needs of retail investors who are not expert in financial and investing matters and of other infrequent investors in or holders of municipal securities."[39] Rather than depart from this principle, greater effort should be made to ensure that retail investors better understand – or, at the very least, are made aware of – the information available to them for free on TRACE and EMMA.

Currently, TRACE and EMMA provide a wealth of information about secondary market transactions that are relevant to the Proposals' policy objective: all transactions in a particular CUSIP by date and time; the price of every transaction; information about the quantity of transactions; whether a transaction was with a dealer or customer; information about the bond's yield; as well as information about the bond and issuer itself that may bear on prices and likely yields. Moreover, TRACE and EMMA enhancements already planned or underway would allow for greater ease of use by retail investors and would permit an even greater understanding of market prices than the Proposals. For example, the MSRB set forth its vision for "EMMA 2.0" in its Long Range Plan for Market Transparency Products, outlining a series of planned enhancements including improved search functionality, free personalized alerts, integrated displays of information, expanded document and data collection, access to new categories of information, a new real-time central transparency platform (CTP), access to new tools and utilities, and improved investor education.[40] Recently, the MSRB introduced MyEMMA, which "provides customized access to municipal securities information by allowing users to set up alerts to be notified when new information on a particular security or group of securities becomes available on EMMA."[41] This level of personalization allows retail investors a level of understanding far beyond the objectives of the Proposals.[42]

Alternative approaches to post-trade transparency – including the Proposals – come at the expense of other initiatives underway or contemplated, as well as future initiatives not currently contemplated. The MSRB acknowledges its obligation to "guide the marshalling of MSRB resources . . . in the most cost-effective manner to achieve the greatest positive impact on the protection of investors, municipal entities, obligated persons and the public interest."[43] Limited resources would be better spent

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38 MSRB Regulatory Notice at 7.

39 MSRB, Long-Range Plan for Market Transparency Products (Jan. 27, 2012) at 5.

40 *Id* at 5-7.

41 MSRB, 2013 Annual Report at 9.

42 *See* MSRB Regulatory Notice at 19 (asking "[w]ould the disclosure of additional information on EMMA meet some or all of the objectives of this proposal?").

43 MSRB, Long-Range Plan for Market Transparency Products (Jan. 27, 2012) at 2.

ensuring the existing TRACE and EMMA systems are more widely used and potentially more user-friendly, rather than mandating costly new confirmation disclosure requirements with unproven benefits.

D. Alternatives that Embrace Existing FINRA and MSRB Transparency Policy Initiatives and Increase the Usage of TRACE and EMMA By Retail Investors of All Ages – Including Disclosures, Hyperlinks, and Pointers – Would Result in Greater Post-Trade Price Transparency at Significantly Lower Cost.

SIFMA believes that the Proposals should be withdrawn in favor of a uniform approach that relies on existing price transparency platforms. Any new confirmation disclosure should be designed to encourage retail bond investors to access TRACE or EMMA and should coincide with renewed education efforts to help those investors better understand the information available on those systems. In contrast to the astronomical costs and uncertain benefits associated with the Proposals, enhancing retail investors' use of these existing systems – developed over the past two decades after considerable and ongoing investment – would constitute a more cost-effective use of limited resources and result in greater price transparency for investors. As the MSRB acknowledged in its most recent annual report, the Proposal "would provide investors with information generally already publicly available" on EMMA.[44] Information on these platforms allow greater insight into a bond's prevailing market price and market conditions generally than any reference price disclosure contemplated by the Proposals.

Accordingly, SIFMA's first and principal recommendation is that FINRA and the MSRB withdraw the Proposals as formulated in favor of a uniform alternative calling for the use of disclosures, hyperlinks, and pointers on trade confirmations – as well as other forms of investor education – as a means to increasing investor use of post-transaction price transparency already available for free on the TRACE and EMMA platforms. Account opening documentation, quarterly statement disclosures, and confirmation backers also could remind retail investors about the availability of pricing information on TRACE and EMMA, while emphasizing that prices for transactions involving different sizes or characteristics may vary.[45] This approach properly emphasizes TRACE and EMMA at a time when retail investors increasingly rely on the internet and success could be measured by retail usage statistics and penetration rates.

FINRA and the MSRB could think more broadly about how to make corporate and municipal bond trading data available to retail investors, for example, by making the data available to application developers who may be able to develop novel ways to

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44 MSRB, 2014 Annual Report at 6.

45 *See, e.g.*, Regulation NMS Rule 606 (detailing customer disclosure obligations related to order routing practices).

drive relevant data to investors in ways that FINRA and the MSRB may not have imagined. For a fraction of the cost of implementing the Proposals, FINRA and the MSRB could incentivize application developers for such an effort. In short, FINRA and the MSRB should consider how to use the systems it has already developed, in conjunction with rapidly developing, forward-looking technology to drive solutions, rather than focusing on confirmation delivered disclosure.

Consistent with prior regulatory guidance and in light of continued growth in internet access and usage, FINRA and the MSRB should adopt an "access equals delivery" model with respect to pricing information available on TRACE and EMMA. NASD previously recognized the need "to modernize prospectus delivery obligations in view of technological and market structure developments of recent years."[46] Similarly, the MSRB argued that an "access equals delivery" standard for official statement deliveries would "promote significantly more effective and efficient delivery of material information" than physical delivery.[47] This reasoning applies in the same way to pricing information available on TRACE and EMMA.

The SEC, FINRA, and MSRB should increase investor education efforts with a special emphasis on increasing usage of TRACE and EMMA. SIFMA is prepared to engage and assist with these efforts. Improving retail investor knowledge about TRACE and EMMA is a natural extension of FINRA and the MSRB's existing education initiatives. For example, among its several educational efforts, the MSRB recently introduced a series of investor education videos – including a video for first-time users of the EMMA website explaining "how investors can use EMMA to learn about the municipal market, evaluate municipal bond features, risks and prices, and monitor the health of their municipal bond investments over time" – the success of which was noted in MSRB's annual report less than a year ago.[48] Given the suggestion that some retail investors are unaware of or choose not to use TRACE and EMMA, FINRA and the MSRB should redouble their efforts to encourage use of these systems and to ensure that investors understand the information available to them. SIFMA has historically funded a variety of investor education efforts and is prepared to support new initiatives to improve investor knowledge and usage of TRACE and EMMA.

II. SPECIFIC ISSUES WITH THE CURRENT PROPOSALS DEMONSTRATE THAT THE PROPOSALS ARE UNWORKABLE.

As formulated, the Matched Trade Proposals risk confusing the very group of retail bond investors that the new disclosure was designed to help. Having a

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[46] NASD, Report of the Mutual Fund Task Force: Mutual Fund Distribution (Mar. 29, 2005).

[47] MSRB Regulatory Notice 2006-19, MSRB Seeks Comments on Application of "Access Equals Delivery" Standard to Official Statement Dissemination for New Issue Municipal Securities (July 27, 2006).

[48] MSRB, 2013 Annual Report at 9.

transaction confirmation disclose the difference between the price of a "reference transaction" and the customer's transaction price on some bond transactions, in circumstances in which the "matched" transactions may be riskless principal transactions (or not), occurring during periods in which prices remain static (or not), so that the figure approximates dealer compensation (or not), as long as the transaction is with a retail customer (or not) and does not involve bonds held in inventory (for longer than a day) is a recipe for investor confusion, not education. A number of specific problems show that the Matched Trade Proposals are unworkable as designed.

First, the Proposals invite retail investors to equate the difference in price between artificially matched trades as dealer compensation when circumstances suggest otherwise. (Parts II.A, B, and E.) Next, by focusing exclusively on a subset of matched or reference transactions that do not exist absent an artificial methodology, the Proposals threaten a cascade of unintended – and likely intractable – problems for dealers and retail customers alike. The issues presented by affiliated entities are left entirely unaddressed and seem not to have been considered at all. (Part II.C.) Moreover, the Proposals – with but a single question – fail to explain why inferior "reference transaction" price disclosure should compete with existing disclosure about underwriting fees and selling concessions in offering documents for new issues (Part II.D) or why longstanding differences in how institutional-sized transactions are priced should be ignored when creating a new category of "reference transaction" disclosure (Part II.E). Indeed, as currently formulated the Proposals would broadly apply to many transactions with institutional customers. (Part II.F.)

But even if FINRA and the MSRB limited the scope of the Proposals to address these difficulties, the operational challenges to the design and implementation of the Proposals would still be far more daunting than acknowledged. From the need to design matching logic to the potentially insurmountable impediments of reaching across desks and entities to match, calculate, and populate configurable fields while relying on third party correspondent firms and data providers, the resources that would be demanded by the Proposals would dwarf any claimed benefits envisioned by the Proposals. (Part II.G.)

A. As Proposed, the Matching Methodology Would Capture At-Risk Trades and Compel "Price Differential" Disclosure that Will Be Confused with Dealer Compensation.

There is a substantial risk that retail customers would be confused by price differential disclosure when trades matched pursuant to the specified methodology are not truly riskless principal trades or when the reference trade is not close in time to the customer trade. In these circumstances, the disclosure may portray an inaccurate picture of the market pricing for the security. For example, if the market price of the bond shifted between the reference transaction and the customer transaction, the difference between the two prices will reflect, at least to some degree, profit or loss related to market risk. Profit or loss related to market risk, however, is not the same as the dealer compensation the Proposals claim they were designed to address. The

meaningfulness of the reference price differential – which is already an inexact proxy for dealer compensation – necessarily degrades over time and could be misleading to customers because the data may imply that the dealer received either more or less compensation than it actually did.

Over time many factors can impact the price of a fixed income security.[49] These factors may cause the price of the customer trade to vary significantly from the price of a reference transaction over time. For example, to the extent the market yield is correlated to a benchmark security, such as the 10 year Treasury, the benchmark yield may shift, changing the price of the security. Market events and changes to risk perceptions that may be unrelated to the particular issuer can cause the spread between the benchmark yield and the yield on the bond the customer is trading to widen or narrow. Idiosyncratic events may affect the price of the particular issue. The lower the credit quality, the more likely is the price to be effected by idiosyncratic events. These multiple features of bond pricing increase the noise and decrease the signal implicit in the reference price information over time. Indeed, current FINRA and MSRB fair pricing guidance identify a host of factors that can have a dramatic impact on prices on an intraday basis.

The relevance of the price at which a dealer transacted in a particular bond compared to the price charged to a customer decreases over time. Although the FINRA Proposal observed that more than half of retail bond transactions involved a corresponding principal trade within 30 minutes of the customer transaction, the Proposals are not so limited and apply to trades that occur over the course of the entire trading day.[50] Indeed, according to studies of secondary market transactions, all or nearly all of the relevant universe of "paired trades" occur within a very short window calculated to be between 5 and 15 minutes.[51] Since the stated purpose of the Proposals is to provide information to customers to assess their transactions, the confirmation disclosure ought not to apply to those trades that do not provide useful information to customers and that have the potential for confusion. The Proposals fail to justify why a "same day" approach is appropriate given the capture of so many unrelated trades in the pairing methodology.

Left unchanged, the Proposals would bring about disclosure to retail customers about price differentials that include or fail to include these factors, which will obfuscate the dealer compensation that the disclosure aims to accomplish. Customer confusion has real costs to firms and associated persons. Firms will need to expend

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[49] *See, e.g.*, FINRA Rule 2121.02(b)(4).

[50] The FINRA Regulatory Notice observed that 3Q 2013 TRACE data showed that over 60% of retail size trades had a corresponding principal trade on the same trading day, and that in over 88% of these trades the principal and customer trades occurred within 30 minutes. FINRA Regulatory Notice at 2.

[51] MSRB, Report on Secondary Market Trading in the Municipal Securities Market (July 2014) at 24 (Figure III.F).

resources to explain to customers why the pricing information is on the confirmation and why the prices are not related to each other. In addition, the disclosure could trigger unfounded customer complaints, which could in turn require disclosures on a registered representative's Form U4. As the Form U4 disclosure obligations are allegation driven and publicly reported through BrokerCheck, client confusion about pricing that leads to unfounded customer complaints may be unjustly harmful to the registered persons who are unfairly the subject of complaints based on misunderstandings.

As designed, the Proposals present a number of foreseeable risks, with unforeseen risks that may manifest themselves upon implementation. Aside from the near certain risk that retail customers will confuse the price differential figure with dealer compensation, the sporadic appearance of the disclosure will also surely – and understandably – result in a flood of calls questioning why some (but not all) transaction confirmations identify a reference transaction and accompanying calculation. There is simply no good answer for firms to give. As formulated, the disclosure requirement would be incapable of summary description. It is decidedly – and by its terms – not a mark-up, a commission, the prevailing market price, or some other familiar term. Nor could it be described as occasioned by the dealer acting in a particular capacity (agent or principal or riskless principal) already known to them. Call centers and registered representatives would be in the unenviable position of trying to learn and communicate the FINRA and MSRB matching methodologies (including LIFO, FIFO, and average weighted price principles) and explain how this figure may bear on an assessment of their transaction and why it appears on some but not all transaction confirmations. By altering the traditional use of the confirmation as a type of invoice describing (i.e., "confirming") the terms of the specific transaction, the Proposals will cause unnecessary customer confusion.

Customer confusion about dealer compensation or the quality of execution that would be triggered by matching unrelated transactions also risks customer retreat from the secondary bond markets and related diminution in liquidity. There is no suggestion in the Proposals that this risk has been evaluated beyond an acknowledgement that bond market liquidity is a relevant consideration.[52] For this reason among others, SIFMA believes that any disclosure obligation with specific price references should be limited to actual riskless principal transactions as described in Part III.B.

B. The Proposals Do Not Consider the Risk of Customer Confusion When the Price Differential Would Result in a Negative Figure.

There is also a substantial risk that retail customers will be confused by price differential disclosure when trades matched pursuant to the specified methodology result in a negative price differential. (FINRA's illustrative examples do not address this very real occurrence, though a recent FINRA/MSRB webinar confirmed the staff's view that customers should be provided with a negative figure in such a circumstance.)

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[52] FINRA Regulatory Notice at 9; MSRB Regulatory Notice at 17.

This risk of confusion would be most acute when retail investors understandably equate the price differential disclosure with a dealer's mark-up. FINRA and the MSRB should consider the risk that a retail investor, seeing a negative price differential, may actually reach an erroneous conclusion that a dealer sold bonds at or below the prevailing market price. By contrast, a review of TRACE or EMMA prints easily accessible online (or through a push notice) would make clear that the market had moved and allow a better assessment of the transaction price than the proposed disclosure.

For example, if a dealer purchased a bond at par in the morning and sold it to a customer at 99 in the afternoon, the matched price disclosure would require the disclosure of -1.0. Were a retail customer to equate this figure with the amount of the dealer's mark-up, he or she may believe that the dealer sold the bonds at one point below the prevailing market price – an erroneous conclusion suggested by the proposed matching methodology.

C. The Proposals Fail To Recognize the Complications Associated with Transactions by Affiliated Broker-Dealers or Separate Trading Desks within the Same Member Firm.

The Matched Trade Proposals do not address ordinary situations in which affiliated broker-dealers or separate trading desks may transact in a manner that has the potential to trigger the proposed matching and related disclosure requirement. SIFMA believes that, as a general matter, transactions by different legal entities or separate trading desks should not be treated as though they resulted from a single trading operation, so as not to disregard legal and operational boundaries that are observed in fact. But SIFMA is also mindful that certain of the policy choices reflected in the structure of the Proposals – for example, excluding sales from aged inventory from the scope of the requirement – may be frustrated by some of the mechanisms used to transact by larger financial services firms. These complications demonstrate the need to fundamentally revisit the "reference transaction" approach in favor of something more workable and effective.

1. Separate Trading Desks.

Absent revision or clarification, the Proposals create uncertainty as to whether transactions executed by separate trading desks and businesses that operate independently would be treated as reference transactions when they were entirely unrelated. Many firms have their institutional bond trading department separate from their retail bond trading department, as well as operate separate proprietary trading desks. These firms may observe formal separation principles, operate the desks as different "aggregation units," or, depending on the circumstances, simply have them function as different businesses with different P&Ls and staff, often with one trading desk a customer of the other. The Proposals do not address whether member firms would be obliged to treat trades on a separate institutional desk in the same legal entity as reference trades for retail customer transactions, or whether they must evaluate

trading activity on the proprietary desk (where such are permitted to exist) as potential reference transactions.

These situations present both substantive and operational complexity. On the substance, an unrelated purchase of bonds by a proprietary trading desk occurring coincidentally on the same day that the retail trading desk sells the same bond to a retail customer from inventory or from another source would not reveal anything meaningful about dealer compensation. Yet the Proposals may require firms to treat the trade from the proprietary desk as a "reference transaction" for the customer trade, incorrectly suggesting a linkage or that they were two legs of a riskless principal transaction. The same problem exists with separate institutional and retail trading desks. In terms of operational complexity, some member firms operate their institutional bond department on a different trading or settlement platform than their retail bond department. Incorporating reference data from a separate platform used by the institutional bond department onto the retail confirmation would be extremely difficult.

2. Transactions by Affiliated Firms.

At some financial services firms, the retail bond desk and institutional bond desk may be in separate affiliated member firms, complicating application of the reference transaction methodology. Some firms may also have affiliates that are dually-registered investment adviser / broker-dealers operating primarily as asset managers. Transactions between affiliates should not be treated as one leg of a paired trade. For example, a purchase by an asset management affiliate for an advisory client should not be treated a "reference transaction" for an entirely unrelated sale of the same bond held in inventory by the retail trading affiliate. Yet the Proposals may compel that result. Nor should transactions executed on behalf of advisory clients by dually registered broker-dealer / investment advisers on an agency basis be used as reference transactions or require confirmation disclosure of reference transactions.

Similarly, many firms accumulate at-risk inventory positions in one affiliate and transact with retail customers in a separate affiliate. For example, it is a rather commonplace occurrence for an institutional trading affiliate to accumulate a large inventory position in a particular bond over several days, and then show the bonds out to its retail trading affiliate (and through it, to retail customers). As retail customers choose to buy small lots in that bond from the retail trading affiliate, customer orders are filled through riskless principal transactions with the institutional affiliate. Treating the inter-affiliate, dealer-to-dealer transaction as a qualifying reference transaction would produce meaningless disclosure. What was essentially a type of inventory trade would be treated otherwise. If firms were instead required to look through to the original acquisition by the affiliate, this would result in additional operational costs and burdens to match trades that occurred in separate entities to confirm whether the transaction was more in the nature of an inventory transaction. Affiliate to affiliate transfers are tantamount to an internal booking move and should not be viewed as a matching trade for a customer trade. Otherwise, customers of an

entity employing one entity will be treated differently than those with the affiliate structure for what are comparable trades.

D. The Proposals Are Unnecessarily Vague as to Their Application to New Issues.

The proposed confirmation disclosure should not apply to new issues of corporate or municipal debt securities. With the exception of the request for comment on whether the confirmation disclosure obligation should apply to new issue trades[53] and the MSRB's acknowledgement that its preliminary statistics excluded new issues,[54] the Proposals do not address their intended applicability to new issues. As a general matter, a dealer's underwriting compensation is disclosed in the offering documents and historically has been addressed in rules separate from those governing secondary market activity. There is no reason to start merging these obligations through the proposed confirmation disclosure.

FINRA's corporate financing rule (FINRA Rule 5110) sets forth detailed guidance on the calculation and fairness of underwriting compensation that is subject to prospectus disclosure, and MSRB Rule G-32 serves a similar purpose in governing new issues of municipal securities. These rules are separate and apart from the rules governing fair prices and commissions (FINRA Rule 2121 and MSRB G-30) that address dealer compensation on secondary market transactions. The Proposals should not apply for new issues where the underwriter's compensation is described in a prospectus, offering memorandum, official statement or similar document. In these circumstances, the disclosure in the offering materials is relevant; separate (and potentially conflicting) disclosure of reference pricing is not.

E. The Proposals Do Not Take Into Account Legitimate Differences in Pricing for Institutional-Sized Trades and the Implications of Using Those as "Reference Transactions."

The difference between the price of the reference transaction and the price of the customer trade would be confusing when the reference transaction is with an institution or another dealer (either directly or through an inter-dealer broker). The Proposals do not take into account the legitimate pricing differences that occur between institutional, dealer, and retail trades.[55] As proposed, the confirmation disclosure obligation would apply in instances where the reference transaction is with an institution (or with another dealer, or with another retail customer) and the customer trade is with a retail customer. But trades with institutions, dealers, or other retail

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53 *See* FINRA Regulatory Notice at 11; MSRB Regulatory Notice at 18.

54 *See* MSRB Regulatory Notice at 10.

55 *See* Letter from Sharon K. Zackula, NASD, to Katherine A. England, SEC (Oct. 4, 2005) ("[C]ommenters agree with NASD's recognition that a bond's contemporaneous cost may not reflect the [prevailing market price] in the case of certain large trades . . . .").

customers in a particular bond may be priced differently from each other, and institutional and dealer trades are priced differently than retail trades. For institutional trades, any mark-up may already be included in the price. Retail trades generally require far more effort than institutional trades, a point repeatedly acknowledged by the SEC, FINRA, and the MSRB in a variety of contexts.[56]

F. Although Designed To Benefit Retail Customers, as Proposed the Confirmation Disclosure Obligation Would Apply to Many Transactions with Institutional and Other Sophisticated Customers.

Although the 100 bond / $100,000 par amount threshold will generally capture retail trades and not institutional trades, institutional and other sophisticated investors often transact at the $100,000 par amount level.[57] For this reason among others, SIFMA strongly urges the exclusion of transactions with institutional and other sophisticated investors from any confirmation disclosure obligation with specific price references using existing FINRA and MSRB definitions.[58] While the Proposals aim to provide additional information to retail investors, they specifically recognize that they could capture some transactions for institutional accounts.[59] Calculating the price differential figure and making customer confirmation disclosure to these types of institutional and other sophisticated investors is well beyond the policy objectives of the Proposals. Recent SEC and GAO reports have emphasized that institutional investors have an abundance of pricing information already accessible and rely on

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[56] *See, e.g.*, District Bus. Comm. for District No. 5 v. MMAR Group, Inc., Complaint No. C05940001, 1996 NASD Discip. LEXIS 66, at *39 (Oct. 22, 1996) ("[T]he size of a transaction is an important factor to consider in determining the mark-up or the mark-down and . . . the percentage mark-up or mark-down should decline as the size of the transaction increases."); In re Century Capital Corp., Exchange Act Rel. No. 31203, 1992 SEC LEXIS 2335, at *8 n.10 (Sept. 21, 1992) (noting that a mark-up above 5% may be reasonable if size of total transaction is small and total compensation is reasonable), *aff'd* 22 F. 3d 1184 (D.C. Cir. 1994); In re Gateway Stock & Bond, Inc., Exchange Act Rel. No. 8003, 1966 SEC LEXIS 194, at *8 (Dec. 8, 1966) (setting aside an NASD finding of unfair pricing in which a mark-up of 7.3% was charged "where only 10 shares" were sold to the customer); MSRB Rule G-30, Supplementary Material .02(b) ("To the extent that institutional transactions are often larger than retail transactions, this factor may enter into the fair and reasonable pricing of retail versus institutional transactions.").

[57] The Proposals' use of the term "100 bonds" should be clarified to simply refer to the par or face amount. Referring to "bonds" in $1,000 increments is a type of trader jargon that may present unforeseen (and unnecessary) interpretative difficulty for certain instruments. Referring to a bond's par or face value is more precise and would avoid any such difficulty.

[58] *See infra* Part III.C.

[59] For example, the MSRB Regulatory Notice states that "[t]he proposal categorizes a transaction involving 100 bonds or fewer or bonds in a par amount of $100,000 or less as a retail-size transaction. However, this approach may not necessarily capture every retail trade and may, in some instances, capture some small trades executed on behalf of an institutional customer." MSRB Regulatory Notice at 9-10.

TRACE and EMMA data on existing data feeds,[60] and therefore do not have a need for this sort of pushed disclosure.

Moreover, obliging a member firm with a customer base consisting entirely of institutional and other sophisticated customers to comply with an expressly retail-directed disclosure imperative simply because a transaction involves bonds with a $100,000 par value serves no apparent regulatory purpose. Yet any trading by an institutional dealer of bonds in a par amount of $100,000 with an institution would trigger the need to adopt the full panoply of operational and system changes implicated by the Proposals. Such an obligation would be inconsistent with the claim made in the Proposals that they would not have a significant impact on the institutional market for municipal securities.[61]

As described in Part III.C, SIFMA has a specific proposal to exempt institutional transactions using existing standards and definitions. But this particular issue also highlights the need for a more targeted solution and suggests that FINRA and the MSRB should consider how to make better use of the TRACE and EMMA platforms, currently contemplated enhancements such as public user accounts, and related technological innovations such as push notices to voluntary subscribers. These alternatives would avoid unnecessary costs to member firms and the provision of meaningless disclosure to certain investors while allowing retail customers who desire additional pricing data to request near real-time alerts or notices, by CUSIP or otherwise.

G. As Proposed, the Confirmation Disclosure Obligation Would Present Substantial Operational Challenges Related to the Design and Implementation of Matching Instruction Logic.

The Proposals would present enormous operational challenges related to their implementation – challenges that do not appear to have been fully considered. The Proposals would require substantial technical systems and programming changes, as well as coordination among third party providers at the outset and on an ongoing basis. Unnecessarily complicated matching logic compounds these challenges. This structure and the related interdependencies would require significant investments of time and money and significantly outweigh any potential benefit to retail customers.

In addition, the Proposals do not consider the substantial operational challenges concerning the confirmation statement delivery process, particularly in light of

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[60] *See e.g.*, GAO Report to Congressional Committees, Municipal Securities, Overview of Market Structure, Pricing, and Regulation, GAO Report No. 12-265 Municipal Securities (Jan. 2012), at 20-27.

[61] MSRB Regulatory Notice at 11 ("Notably, because the proposal would apply to customer trades for 100 bonds or fewer or bonds in a par amount of $100,000 or less, the disclosure requirement should not have a significant impact on the institutional market for municipal securities.").

initiatives to shorten the settlement cycle. Exchange Act Rule 10b-10, MSRB Rule G-15, and FINRA Rule 2230 require that a broker-dealer that effects a transaction in the account of a customer must provide a confirmation to the customer "at or before the completion of" such transaction. Exchange Act Rule 15c1-1(b) defines "the completion of the transaction" to be, generally, when the customer makes payment to the broker, or when the broker delivers the security to the account of the customer. The Depository Trust & Clearing Corporation ("DTCC") is currently leading an industry effort to shorten the U.S. trade settlement cycle for equities, municipal and corporate bonds, and unit investment trusts ("UITs") from T+3 (trade date plus three days) to T+2 (trade date plus two days).[62] Once achieved, DTCC has recommended a pause and further assessment of industry readiness and appetite for a future move to T+1.[63] The tension between the Proposals' greater disclosure requirements, which can only be added at the end of the trade day, on customer confirmation statements and a shorter settlement cycle adds further complexity and operational risk to this process.

1. The Proposals present substantial technical and programming challenges to their implementation.

Implementing the Proposals would present substantial technical and programming challenges. Placing the proposed information on trade confirmations would be a complicated task. Confirmations already draw on multiple sources of static and dynamic data. For example, trade confirmations obtain information about the security from the security master file, about the customer from the customer master file, and about the trade from the trade file. In addition, the generation of confirmations requires various computations, including accrued interest, yield and price, and total money. The final confirmation includes all the above mentioned information combined from the various sources into a single document.

The Proposals would require firms to add additional information about the reference transaction, perform computations on the price difference between the reference transaction and the customer trade, and print the reference transaction price and the difference between it and the customer trade price on the confirmation, along with the customer trade price – all of which would require costly and complex modifications to firms' systems. These proposed requirements would be especially burdensome in situations in which the reference transaction(s) and the customer trade are not easily associated with each other based on similarities in time or size.

2. The Proposals would require member firms to coordinate and rely on third parties for data necessary for compliance.

Information needed to generate compliant confirmations may reside with different entities, further complicating compliance efforts. Certain information may be

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62 Depository Trust & Clearing Corporation, DTCC Recommends Shortening the U.S. Trade Settlement Cycle, April 2014 (advocating for a move to a two-day settlement period).

63 *Id* at 2.

with the introducing broker, other information may be with the clearing broker, and other information may be with vendors servicing either one. For example, clearing brokers would need to rely on introducing brokers to specify the reference transaction and corresponding information for those firms using their own order management systems. Introducing firms would need to ensure that at least two new fixed fields could be populated and transmitted to their clearing firms in an acceptable format. Clearing brokers (or self-clearing firms) would then need to ensure that these fixed fields are added to the trade record and stored in a fashion that allows use by downstream systems. Systems that generate trade confirmations must be programmed to acknowledge these two new fields (for both COD and non-COD accounts) and populate them to a particular location on the confirmations. As confirmations have become increasingly crowded over the years, space reserved for trailer information would need to be reallocated.

Although the Proposals do not address this point, presumably the new required disclosures would need to be capable of correction, which is also a complicating factor. Clearing firms would need to allow correspondents to view and correct the new fields – requiring storage of numerous versions in the clearing firm's trade history database. Changes made by introducing firms would need to be passed along to the master books and records database. Correspondent firms would need to re-program their own system to ingest and review the changed format of daily standard files received from the clearing firm.

Nor do the Proposals address the obligations that a member firm would have in the event of a cancellation or re-billing of a reference transaction. If a new transaction confirmation would be required, systems at both the introducing firm and the clearing firm would need to have fixed links between the two (or more) separate transactions with re-issue protocols developed. (The potential for customer confusion upon receipt of a re-issued confirmation that changes only the reference price seems particularly acute.)[64]

3. Because "reference transactions" are not limited to riskless principal transactions, the Proposals would force member firms to navigate an overly complicated – and at times conflicting – matching methodology.

The Proposals would force member firms to navigate an overly complicated – and at times conflicting – matching methodology because reference transactions are not limited to riskless principal transactions. By design, this convoluted methodology suggests that the price differential is not readily determinable and therefore is inconsistent with one of the justifications for the specific recommendation in the SEC

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64 *See infra* Part III.F for further discussion of cancellations and corrections.

Municipal Report that the Proposals cite in support.[65] Complex issues may arise under the various methodologies for determining the reference price, as described in the Proposals. Under certain circumstances, the Proposals specify a "last in first out" methodology.[66] Under other circumstances, the Proposals specify an average pricing methodology.[67]

The application of these methodologies to situations in which there is significant buying and selling activity at varying prices and varying size would become quite complex. The Proposals fail to contemplate that it may not be possible to program such methodologies with a high degree of certainty as to accuracy. It is also not clear how these computations would be made, and what disclosure would be included on the customer confirmation, if the customer trade was executed in partial fills and provided to the customer at one confirmation at an average price.

In addition, the Proposals could be read as imposing an obligation to create an automated matching engine for use with confirmation disclosure. SIFMA believes that member firms that engage in a relatively small amount of bond trading should be able to comply with any confirmation disclosure obligation manually, rather than through the use of automated identification of reference transactions and computation of the difference in price between it and the customer trade. If FINRA or the MSRB intend the Proposals to require automated matching systems, such a requirement should be explicitly proposed and separately subjected to robust cost-benefit analysis.

III. IF A NEW CONFIRMATION DISCLOSURE OBLIGATION WITH SPECIFIC PRICE REFERENCES IS TO BE EXPLORED, ALTERNATIVE FORMULATIONS WOULD BETTER ACCOMPLISH THE DESIRED REGULATORY OBJECTIVE – BUT SIFMA BELIEVES THE COSTS ALSO OUTWEIGH THE PURPORTED BENEFITS IN THESE ALTERNATIVE FORMULATIONS.

A. Any New Confirmation Requirement Must be Uniform in Design and Operation as Part of an Overall Approach to Consistency in Rulemaking.

Although the Proposals promised a "coordinated approach to potential rulemaking," they use different formulations that invite unnecessary ambiguity and differing interpretation. The companion Proposals appear designed to operate in an identical fashion – with the MSRB even referencing FINRA's thirteen examples – yet they use different terms and organization. For example, the MSRB proposal uses the

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65 SEC Municipal Report at 148 (tying recommended confirmation disclosure to the "readily determinable" markup on riskless principal transactions); MSRB Regulatory Notice at 4 (citing the SEC Municipal Report as the basis for the Proposal); FINRA Regulatory Notice at 3 (same).

66 *See, e.g.*, MSRB Regulatory Notice at 11; FINRA Regulatory Notice at 6.

67 *See* FINRA Regulatory Notice at 5.

term "reference transaction" to refer to the same category of same day transactions that the FINRA proposal describes similarly but using different words and without definition.[68] The FINRA proposal defines the term "Qualifying Size" to refer to the same size criteria that the MSRB proposal details in slightly different wording.[69] The MSRB proposal applies to trades "effected" as a principal, while FINRA's proposal applies to trades "executed" as a principal.[70] The FINRA proposal requires disclosure of the "differential between . . . the price to the member and the price to the customer" while the MSRB proposal requires disclosure of the "difference in price between the reference transaction and the customer trade, expressed as a percentage of par" – which seems the same, but creates totally unnecessary ambiguity.[71]

In the context of potential customer confirmation disclosure requirements, there is no justification for differences in structure and terminology. While differences in the markets for corporate and municipal debt securities often compel differing approaches to regulation, no purpose would be served by differently worded rules that are designed to operate identically. Unnecessary differences in formulation or terminology can result (and regrettably have resulted) in divergent regulatory approaches and interpretive guidance over time – which, in turn, increase the risk of noncompliance and the need to develop overlapping policies. Unnecessarily divergent

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[68] The MSRB proposal states, "A *reference transaction* generally is one in which the dealer, as principal, purchases or sells the same security that is the subject of the confirmation on the same date as the customer trade." MSRB Regulatory Notice at 8 (emphasis added). By contrast, the FINRA proposal states, "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." FINRA Regulatory Notice at 3.

[69] FINRA states, "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." FINRA Regulatory Notice at 3 (emphasis added). By contrast, the MSRB states, "The proposal categorizes a transaction involving 100 bonds or fewer or bonds in a par amount of $100,000 or less as a retail-size transaction." MSRB Regulatory Notice at 21.

[70] *Compare* FINRA Regulatory Notice at 17, *with* MSRB Regulatory Notice at 21.

[71] The FINRA proposal states, "(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)." FINRA Regulatory Notice at 17 (emphasis added). The MSRB proposal states, "the confirmation shall include: . . . (2) the difference in price between the reference transaction (as defined in paragraph (a)(vi)(I) of this rule) and the customer trade, expressed as a percentage of par." MSRB Regulatory Notice at 21.

approaches to trade reporting of transactions executed on or through an ATS is a recent example.[72] The failure to pursue cost effective solutions and to coordinate approaches between regulators (including uniform rules where reasonable) prevents operational efficiencies and inflates cost structures for dealers. Such regulatory failures only serve to reduce a dealer's ability to provide products and services in the most cost effective manner. Unlike the need to vary approaches to secondary trading execution obligations and fair pricing in the market for municipal and corporate debt securities, operational instructions concerning customer confirmation disclosure should be uniform and precise.[73] Whenever possible, including here, the SEC and SROs should seek to minimize unnecessary differences in regulatory obligations that serve the same or similar objective. Indeed, FINRA's rulebook consolidation effort was a multi-year exercise in eliminating unnecessarily dissonant, conflicting, or duplicative regulatory obligations. There is no apparent justification for the differences between the Proposals and they should be made identical.

B. Any Confirmation Disclosure Obligation with Specific Price References Should Apply Only to Riskless Principal Transactions with Retail Investors To Avoid Investor Confusion and To Ensure Greater Consistency with Current Obligations for Equity Transactions.

The Proposals as currently structured would capture both at risk and riskless principal trades. SIFMA believes, however, that any confirmation disclosure obligation with specific price references should be limited to those trades with retail investors in which the dealer does not incur market risk, i.e., truly riskless principal trades. To be clear, SIFMA strongly favors an approach that uses TRACE and EMMA to increase price transparency. Disclosure of dealer compensation on even riskless principal trades would still require enormously costly build-outs and changes to operational back office systems, cross-platform challenges, and changes to existing front-end systems and practices, all of which led the SEC to withdraw similar proposals in the past. For these reasons, SIFMA believes that the benefits of any such proposal would be far outweighed by the extraordinary costs of implementation. Disclosure of mark-ups or mark-downs on riskless principal trades, however, would appear to potentially have several advantages over the Proposals. First, the disclosure of dealer compensation on riskless principal trades with retail investors is at least consistent with SEC recommendations in this area as well as the purpose of the Proposals – to provide retail customers with information about dealer compensation. Second, it would avoid retail customer confusion by providing information related to the trade being confirmed, not information about other, unrelated trades as the

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[72] *See, e.g.*, FINRA Regulatory Notice 14-53, which unnecessarily diverged from an entirely reasonable MSRB approach to the same issue involving alternative trading systems.

[73] *See, e.g.*, MSRB Notice 2014-02 (Feb. 19, 2014) (detailing an effort to "propose a best-execution rule that is generally harmonized with FINRA Rule 5310 but tailored to the characteristics of the municipal securities market").

Proposals would otherwise require. Third, riskless principal disclosure would avoid the confusion inherent in the identification of other types of reference transactions.

1. Riskless principal transactions should be classified using an established definition, which requires offsetting orders.

A riskless principal transaction should be regarded as the functional equivalent of an agency trade, in which no principal risk (other than settlement risk) attaches to the dealer effecting the transaction. It is particularly important that risk transactions not be regarded as "riskless" solely because of their timing, or definitional ambiguities about what constitutes an order in the debt securities markets. Dealers often acquire debt securities in the expectation that they will meet known or anticipated customer interest, and customer transactions involving those securities may be executed shortly after a dealer acquires a position, in the same face amount, in a manner that resembles a "matched" or "crossed" transaction. However, such expectations of customer interest are not "orders," and until the security is sold, the dealer is entirely at risk. Underscoring this longstanding distinction, a leading treatise authored by former SEC Chief Economist Larry Harris defines "orders" as "trade instructions" that "specify what traders want to trade, whether to buy or sell, how much, when and how to trade, and, most important, on what terms."[74] In short, orders are actionable instructions to transact and any need to "firm up" or obtain customer assent to particular terms is inconsistent with an order as such.

The SEC has previously emphasized the importance of an order in hand as a predicate to a riskless principal transaction:

> In the respects relevant here, a trade on a riskless principal basis should be treated similarly to an agency transaction, in which a firm may retain no more than a commission computed on the basis of its cost. As we have noted, a riskless principal transaction is the economic equivalent of an agency trade. Like an agent, a firm engaging in such trades has no market making function, buys only to fill orders already in hand, and immediately "books" the shares it buys to its customers. Essentially the firm serves as an intermediary for others who have assumed the market risk.[75]

The existing provision of the SEC's confirmation rule applicable to certain riskless principal trades in equity securities by non-market maker dealers also emphasizes the need for offsetting orders. Exchange Act Rule 10b-10(a)(2)(ii)(A) applies to circumstances in which a "broker or dealer [that] is not a market maker in an equity

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[74] LARRY HARRIS, TRADING AND EXCHANGES: MARKET MICROSTRUCTURE FOR PRACTITIONERS 68 (2003).

[75] In re Kevin B. Waide, Exchange Act Rel. No. 30561 (Apr. 7, 1992).

security and, if, after having received an order to buy from a customer, the broker or dealer purchased the equity security from another person to offset a contemporaneous sale to such customer, the broker or dealer sold the security to another person to offset a contemporaneous purchase from such customer."[76] FINRA trade reporting rules also recognize the importance of offsetting orders as a predicate to a "riskless principal transaction."[77]

2. Disclosure of dealer compensation on riskless principal trades, not on at-risk trades, is more consistent with the SEC's recommendation and the Proposals' stated regulatory purpose.

Disclosure of the difference between the customer trade price and the reference transaction price on riskless principal trades is closest to the type of markup disclosure that the SEC has previously proposed and to the recommendation in the SEC Municipal Report.[78] As SIFMA understands the Proposals, the policy objective behind the confirmation disclosure requirement is to help bond investors understand the amount of dealer compensation in circumstances in which the amount of mark-up is "readily determinable."[79] In this regard, the SEC has stated that "[b]ecause riskless principal transactions are very similar, as a practical matter, to agency transactions, and the amount of the mark-up or mark-down is readily determinable, confirmation disclosure of a municipal bond dealer's compensation in these circumstances should allow customers to more effectively assess the fairness of the prices provided by dealers."[80]

The recommendation included in the SEC Municipal Report was limited to disclosure of the mark-up or mark-down on riskless principal transactions in order to provide customers information about dealer compensation. As the SEC Municipal Report pointed out, in the context of such trades, the mark-up or mark-down is "readily determinable" – an acknowledgement that alternatives would be more complicated and

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[76] *See also* Exchange Act Rule 3a5-1(b) ("[T]he term riskless principal transaction means a transaction in which, after having received an order to buy from a customer, the bank purchased the security from another person to offset a contemporaneous sale to such customer or, after having received an order to sell from a customer, the bank sold the security to another person to offset a contemporaneous purchase from such customer.").

[77] As recently as 2010, the MSRB also proposed to define a "riskless principal transaction" as "a transaction in which, after receiving an order from a customer, the dealer purchased the security from another person to offset a contemporaneous sale to such customer or, having received an order to sell from a customer, the dealer sold the security to another person to offset a contemporaneous purchase from such customer." MSRB Regulatory Notice 2010-10 (Apr. 21, 2010).

[78] SEC Municipal Report at 148.

[79] FINRA Reg. Notice 14-52 at 3 n.5 (citing SEC Municipal Report).

[80] SEC Municipal Report at 148.

potentially confusing to investors. The Report also explained that limiting such disclosure to riskless principal transactions would be "comparable" to existing Rule 10b-10 disclosure for certain equity transactions.[81] In fact, given the current state of corporate and municipal bond transaction reporting on TRACE and EMMA, any new confirmation disclosure requirement with specific price references ought to focus on the set of readily auditable riskless principal trades:

> In the past, limitations on the data reported for municipal securities transactions may have made it difficult to identify riskless principal transactions, for purposes of compliance with – and enforcement of – a rule requiring disclosure of markups or markdowns on such transactions. These limitations are no longer present in today's market, as pricing data on municipal securities transactions is reported soon after execution. Thus, we already have the data necessary to identify riskless principal transactions.[82]

3. Riskless principal transactions can be more reasonably identified but a disclosure requirement will still require significant technology and compliance expense to implement.

The disclosure of mark-ups or mark-downs on riskless principal trades most closely identifies dealer compensation, the information that the SEC believes is germane to customers. A riskless principal disclosure requirement is likely to necessitate the development of order tracking systems together with compliance surveillance and monitoring programs to ensure riskless principal transactions are properly identified in such systems or otherwise flagged in existing systems. Attempts to match customer trades to reference transactions as described in the Proposals would necessarily require an ex post analysis that would result in the disclosure of, at best, an approximation of dealer compensation that would risk investor confusion.[83] Simple disclosure of the difference in price between transactions executed in the same security at a prior point on the same day risks inaccurately treating any difference in price among transactions on the same day as a "mark-up" – something entirely at odds with FINRA mark-up rules and guidance and MSRB fair pricing rules. For example, the MSRB's Report on Secondary Market Trading in the Municipal Securities Market noted that "paired-trade differentials and total customer-to-customer differentials . . . generally do not equate to the formal concepts of 'mark-up' and 'mark-down,' . . . and generally would not be suitable for making direct comparisons to individual

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81 SEC Municipal Report at 148-49.

82 Commissioner Michael S. Piwowar, Remarks at the 2014 Municipal Finance Conference presented by The Bond Buyer and Brandeis Int'l Business School, Boston, Massachusetts (Aug. 1, 2014).

83 *See supra* Part II.A.

transactions in the current market."[84] There are still differences between agency disclosure and riskless principal disclosure that could cause customer confusion, the resulting costs of which still would need to be carefully considered. For example, in a riskless principal trade between two customers, each customer would receive the disclosure of the entire difference between the buy and sell price. This disclosure differs significantly from the typical agency transaction disclosure, where each customer confirmation would generally disclose the amount of commission paid just by that customer.

4. The identification of riskless principal transactions would avoid confusion inherent in identifying other types of reference transactions.

Identification of riskless principal transactions is less confusing and less uncertain than the identification of reference transactions that may occur at any time during the day and that may not be related in any meaningful commercial way to the customer trade. Traders would know whether trades are riskless or not, and could classify them as such, or firms could otherwise identify them at the time of trade. Classifications could be surveilled through order memoranda or related contemporaneous transaction documentation to determine whether riskless principal trades have been properly identified for disclosure of the reference transaction price on the trade confirmation. Firms' supervisory and compliance programs could be designed to test and verify the status of close-in-time executions.

Absent a limitation to riskless principal transactions, there is a risk that credit events will occur between the two (or several) legs of the matched transactions subject to the confirmation disclosure obligation as currently proposed. Customers may conclude that the difference in price is entirely a mark-up (which is indeed the implication of the disclosure), when in fact some portion of it would reflect a change in the bond's value or prevailing market price. FINRA and the MSRB have long acknowledged that credit events and news can have a significant and immediate impact on bond values, and permit dealers to consider these developments when assessing prevailing market prices.

Although SIFMA believes that a retail riskless principal disclosure requirement would impose enormous costs and burdens that would still outweigh the benefits – especially in light of the suggested alternative to promote greater usage of existing transparency platforms – any further regulatory pursuit of a price specific disclosure requirement should entail a reproposal with a focus on disclosure of dealer compensation solely in the context of riskless principal trades.

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[84] MSRB, Report on Secondary Market Trading in the Municipal Securities Market (July 2014).

C. Any Confirmation Disclosure Obligation With Specific Price References Should Be More Carefully Tailored To Apply Only to Retail Customers.

Institutional and other sophisticated customers often transact in bonds with a par value of $100,000. Accordingly, the "qualifying size" (FINRA) or threshold for providing pricing reference information (MSRB) should be changed to 99 bonds or fewer or $99,999 or less to avoid the substantial number of non-retail transactions at the $100,000 level.[85] FINRA has previously used "less than $100,000" as a standard for identifying retail bond transactions, instead of the proposed "$100,000 or less" metric.[86] In particular, 72.8 percent of transactions in municipal securities involve $50,000 or less in face amount. An additional 12.5 percent of transactions in municipal securities involve $50,001 - $100,000 in face amount.[87] Accordingly, setting the threshold at $99,999 or less would trigger the disclosure requirement in approximately 80 percent of all transactions with a reference transaction.

In addition to establishing more appropriate quantity thresholds, any confirmation disclosure obligation with specific price references should also use defined terms to exclude institutional and other sophisticated investors. Institutions and other sophisticated customers also regularly transact in quantities below $100,000 par amount when exiting orphan positions or accumulating a larger, desired position incrementally. Moreover, institutions and other sophisticated investors have multiple dealer relationships that provide additional insight into bond prices and the fixed income market more generally. For these reasons among others, an additional improvement on the approach taken by the Proposals to limit application of the disclosure requirement to retail transactions would be to also exclude transactions from the requirement that are with a defined set of institutional customers and customers recognized by statute as having a high level of financial sophistication and/or investable assets.[88] The Proposals are appropriately focused on the need (if any) for additional confirmation disclosure for retail bond investors. For a variety of reasons, institutional and other sophisticated investors do not need the type of disclosure called for by the Proposals – a point acknowledged in the SEC Municipal Report:

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[85] As set forth above at note 57, SIFMA urges FINRA and the MSRB to avoid the use of trader jargon that equates one bond with $1,000 in par or face amount.

[86] *See* Exchange Act Release No. 73623, 79 Fed. Reg. 69,905, 69,907 (Nov. 24, 2014) ("FINRA TRACE data shows that from 2007 through 2013, retail-sized transactions (*defined to mean trades with a face value of less than $100,000*) in corporate bonds increased approximately 97 percent to about 16,000 daily trades.") (emphasis added).

[87] MSRB, Report on Secondary Market Trading in the Municipal Securities Market (July 2014), at 22 (Figure III.C).

[88] "The proposal categorizes a transaction involving 100 bonds or fewer or bonds in a par amount of $100,000 or less as a retail-size transaction. However, this approach may not necessarily capture every retail trade and may, in some instances, capture some small trades executed on behalf of an institutional customer." MSRB Regulatory Notice at 9-10.

> Although institutional investors vary widely in size and sophistication, the larger ones tend to have access to a variety of sources of municipal securities pricing information. This pricing information can include indicative quotes provided by their municipal bond dealer networks and post-trade transaction information provided by vendors and others. Institutional investors also may directly employ analysts, traders, and other professionals who are experienced in using the available informational tools and making independent pricing judgments.[89]

Existing FINRA and MSRB rules and interpretations, specifically MSRB Rule G-8(a)(xi) and FINRA Rule 4512(c) (defining "institutional account"), as well as Investment Company Act Section 2(a)(51) (defining "qualified purchaser"), provide readily available classifications that dealers have already integrated into their business operations. These are the rules that are used to distinguish between retail and non-retail customers in many contexts, and regulators should maintain a consistent approach to making such distinctions. Whether by reference to an "institutional account" or "qualified purchaser," each of these terms reflects a regulatory or congressional determination that investors so classified are sufficiently sophisticated and/or resourced that they are unlikely to rely heavily on dealers to make their investment decisions. Moreover, it is operationally complex and prone to error to have different ways of seeking to distinguish between retail and non-retail customers. Accordingly, these pre-existing classifications should be used to avoid an unnecessary disclosure obligation to institutional and other sophisticated investors.

FINRA and MSRB should further clarify, whichever criteria are ultimately used to classify institutional and other sophisticated customers, that they should be applied at the parent account level, not at the sub account level. For example, transactions with investment advisers in amounts exceeding any qualifying size (whether $100,000 par value as proposed, or the more appropriate $99,999 level) or allocated to retail customers of the investment adviser, should not be subject to the proposed confirmation disclosure obligations. It would be enormously complex and potentially impossible for dealers to allocate various portions of an institutional block trade into retail customers' respective components. (For example, a purchase of $500,000 face amount of a bond by an investment manager on behalf of advisory clients will be booked as allocated and confirmed at the sub account/end customer level, potentially as ten, $50,000 transactions.) The investment adviser or other institution making the transaction decision has access to pricing information, and so

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[89] SEC Municipal Report at 121-122. *See also*, GAO Report No. 12-265, Municipal Securities: Overview of Market Structure, Pricing and Regulation (Jan. 2012) at 20-27 ("individual investors generally have less information and expertise to assess prices than institutional investors.")

disclosures aimed at retail investors should not be required.

D. Any Confirmation Disclosure Obligation Should Allow Separately-Operated Trading Desks To "Match" Only their Own Trades.

When proprietary, retail, and institutional trading desks operate independently, their transactions should not be disclosed in a manner that suggests integration. To the extent a member may set up bona fide aggregation units of bond trading desks, modeled on the aggregation units in Section 200(f) of Regulation SHO, 17 C.F.R. § 242.200(f), it should not need to identify trades in one aggregation unit as reference transactions for customer trades in another aggregation unit. The object of the Proposals would not be advanced by disclosing the price differential between unconnected transactions. For example, if a retail trading desk sells a customer 80 bonds at 99 from inventory and on the same day the same firm's proprietary trading desk is able to acquire 1,000 bonds at 97.5 in a separate transaction, disclosure of the 1.5 point price differential would convey no meaningful information about dealer compensation (the object of the proposal) and would in fact mislead the customer. By allowing dealers to disclose "matched" trades by aggregation unit and dealer MPID, the confirmation disclosure would be consistent with existing TRACE and EMMA transaction reporting obligations.

In addition, any confirmation disclosure requirement should be neutral as to business model. For example, some full service broker-dealers have institutional and retail trading desks within the same member. Others have their retail and institutional desk in different members. By applying the requirement at the aggregation unit level, the Proposals would operate the same and require the same, comparable disclosure, regardless of the structure of the business, even in situations where one aggregation unit sourced liquidity through another aggregation unit.

E. Dealers Should Be Permitted To Disclose a Standard Sales Credit or Mark-up in Lieu of the Confirmation Disclosure of the Proposal.

While SIFMA opposes the mandatory adoption of commission or mark-up schedules generally, in circumstances in which a dealer has an existing sales credit or mark-up schedule that details the compensation that the firm and its salesperson receive for retail bond transactions, disclosure of that schedule to customers via a link on the confirmation or of the actual markup on the confirmation, should satisfy the policy objective behind the requirement. Accordingly, firms should be given the option to choose to disclose mark-ups in this manner in lieu of making the confirmation disclosure (or observing any matching methodology) contemplated by the Proposals. SIFMA reiterates that this approach should be considered as an alternative option available to dealers that transact in this fashion and not as a mandate to create or adopt retail mark-up or commission schedules (which SIFMA has and continues to oppose).

F. Any New Confirmation Requirement Should Not Require Confirmations To Be Canceled and Corrected Due Solely to a Change to the Reference Transaction Price.

In the event any disclosure requirement uses a reference transaction concept, the re-billing or cancellation of a reference transaction should not occasion the issuance of a replacement confirmation for the matched trade unless its terms have also changed. At times, the trade that included the reference price may be cancelled or corrected in a manner that either changes the reference price or that obviates the trade as a reference price trade (for example, if the trade is cancelled outright or was accidentally booked as a buy but needed to be rebooked as a sell). In these instances, SIFMA requests confirmation that Firms would not be required to re-confirm the customer trade.

IV. IN LIGHT OF THE CONSIDERABLE BURDENS ACKNOWLEDGED TO BE ASSOCIATED WITH PROPOSALS, FINRA AND THE MSRB HAVE NOT CONDUCTED AN ADEQUATE COST / BENEFIT ANALYSIS.

As currently formulated, the Proposals may violate the Exchange Act, as well as other federal laws governing SRO rulemaking. These laws require, among other things, that FINRA, the MSRB, and the SEC consider the burdens on competition presented by the Proposals and whether their adoption would impede the operation of the capital markets, including the secondary market for debt securities. Other federal statutes require the consideration and quantification of the effect that the Proposals would have on small business entities, including broker-dealers and issuers of debt securities, and restrict the adoption of new recordkeeping obligations absent compliance with certain procedural requirements. At the urging of the SEC, both FINRA and the MSRB have adopted policies that govern this type of economic impact assessment, designed to facilitate the agency review required by federal law. Indeed, FINRA and the MSRB should not even propose a rule without some meaningful, substantive evidentiary basis – however preliminary – to conclude that the benefits would outweigh the estimated costs and burdens, and not simply evaluate assumed or speculated benefits against invited comments on costs. Yet nothing in the Proposals suggests that FINRA or the MSRB has even begun to compile a record that would either permit an informed analysis of these assessments by public commenters or allow an appropriate review by the SEC offices charged with conducting the agency's review pursuant to Exchange Act Section 19(b)(2). (Part IV.A.)

Nor has there been any apparent consideration of the less burdensome alternatives that are available using existing infrastructure to accomplish the stated regulatory objective. For years the published policy of FINRA and the MSRB has been to use the TRACE and EMMA platforms to increase bond pricing transparency. The costs of these platforms must be considered in the context of a change of approach to accomplishing the same or similar objectives. (Part IV.B.) These costs, coupled with the enormity of the costs and burdens that would be associated with the Proposals

as currently formulated, simply cannot be justified by the putative benefits claimed to accompany the proposed disclosure. (Part IV.C.)

A. By Policy, FINRA and the MSRB Must Each Conduct a Robust Cost-Benefit Analysis that Demonstrates that the Proposals Are Needed, that the Costs Associated with them Are Necessary, and that No Other Less Burdensome Alternatives Would Meet the Objective.

Exchange Act Sections 15A(b)(9) and 15B(b)(2)(C) require that FINRA and MSRB rules "not impose any burden on competition not necessary or appropriate in furtherance of the purposes of [the Act]." Exchange Act Section 3(f) also requires the SEC, when reviewing a proposed rulemaking, to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." To aid in this consideration, SROs must provide a detailed statement regarding the burden on competition that may be imposed by a proposed rule. In the context of a proposed rulemaking, the obligation to justify the new obligation is on the SROs, and they cannot satisfy the requirement to analyze potential costs by simply punting questions to the affected entities.

Each of FINRA and the MSRB has adopted and published formal policies governing economic impact analysis.[90] These policies are quite clear in terms of the obligation to gather, analyze, and publish quantified costs and to catalog the evidence relied upon to arrive at those figures. For example, the MSRB policy provides, in pertinent part:

> The SEC Guidance stresses the need to attempt to quantify anticipated costs and benefits even when the available data is imperfect. In order to quantify costs and benefits, data is necessary. At an early stage in the rulemaking process, the rulemaking staff should identify data sources that would potentially assist in quantification and should attempt to obtain the necessary data. In its public comment process, the MSRB should describe the measurement approach used, include references and descriptions of data used and specify the timeframe analyzed.[91]

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[90] FINRA, Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking (Sept. 2013); MSRB, Policy on the Use of Economic Analysis in MSRB Rulemaking (Sept. 2013).

[91] MSRB, Policy on the Use of Economic Analysis in MSRB Rulemaking (Sept. 2013), at 2. *See also* Mark Schoeff, Jr., *Ketchum: What this industry is missing when it comes to CARDS*, Investment News, Dec. 5, 2014 ("'We think the benefits are absolutely obvious, but we recognize it's always our obligation to look closely at costs,' said Richard Ketchum,

The requirements of the FINRA and MSRB policies are referenced in the Proposals, in corresponding sections that address costs and benefits. Yet nowhere in either regulatory notice is there any description of efforts that were taken or are contemplated to quantify costs, to evaluate the specific costs of "firms developing a new system to capture and deliver required disclosures" (FINRA), or to identify "relevant empirical evidence available" (MSRB).

While the Proposals contain a number of recitals about the need to weigh costs and benefits, there are no statistics – not a single one – that purport to quantify any costs of the proposed requirement, even while acknowledging that "the proposal would impose burdens and costs on firms." As a result, the Proposals balance unmeasured, aspirational benefits against unquantified costs, and preliminarily conclude that the benefits are justified:

> 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 disclosure.[92]

Such a statement presupposes an analysis of data that has been vaguely requested, not yet received, and not the result of any formulated or published methodology. It is so far from the requirements imposed by statute and policy that it suggests an effort to justify a regulatory decision already made – the very opposite of the approach required by FINRA and MSRB policies. When contrasted with the cost-benefit analysis undertaken by the SEC in connection with the most recent amendments to the confirmation rule,[93] the efforts undertaken to date to analyze the Proposals are wholly inadequate and would not withstand administrative or judicial scrutiny.

In addition to the inadequacy of FINRA and the MSRB's cost-benefit analyses to date, neither of the Proposals details any action to comply with the Paperwork Reduction Act of 1995[94] or the Regulatory Flexibility Act.[95] Specifically, any approval by the SEC of the Proposals as currently formulated would create a new "collection of information" requirement by imposing a "recordkeeping requirement" on ten or more persons to identify and track reference transactions and corresponding

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Financial Industry Regulatory Authority Inc. chairman and chief executive.").

92 FINRA Regulatory Notice 15-52 at 10.

93 Mutual Fund Distribution Fees; Confirmations, 75 Fed. Reg. 47,064, 47,126 (Aug. 4, 2010).

94 44 U.S.C. §§ 3501-3510

95 5 U.S.C. § 605(b).

price differentials.[96] The Proposals do not contain any representation that the proposed collection of information has been or will be submitted to the Office of Management and Budget for review of this new recordkeeping requirement. Nor has FINRA or the MSRB explained whether – or on what basis – they would be able to certify to the SEC that the Proposals would not have a significant economic impact on small business entities, such as regional broker-dealers with limited bond trading operations.[97]

Not only are the Proposals lacking in a numbers-driven assessment of the costs and burdens that would be borne by member firms, they do not address or even attempt to measure the potential impact on bond market liquidity. Such an endeavor is entirely within the capability of FINRA and the MSRB, as the recent commission and publication of secondary market analyses by experts retained by the MSRB demonstrates. Such an examination would be consistent with the prudence undertaken by FINRA and the MSRB in the context of trade dissemination and reflect that the risks of even small reduction in retail bond market liquidity could easily injure investors far more seriously than any benefit to be gained by the Proposals.

B. In Light of the Two Decades and Millions of Dollars Spent Pursuing Fixed Income Price Transparency Initiatives through the TRACE and EMMA Platforms, FINRA and the MSRB Must Justify with Particularity a Decision To Ignore Less Costly Alternatives Using This Existing Infrastructure.

Neither FINRA nor the MSRB has explained why, at a time when the bond markets have never had greater transparency, the Proposals – more sweeping and broader than a proposal rejected on four prior occasions based on cost / benefit analyses – is now necessary. Although the Proposals question the willingness of retail investors to "actively seek out information and make inferences as to which transactions are most relevant,"[98] they provide no statistics about usage of TRACE and EMMA or the portion of retail investors who access their accounts electronically or otherwise access the internet for investments or banking. Indeed, until the issuance of the Proposals in November, public pronouncements were replete with figures demonstrating the effectiveness of these platforms.[99]

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96 44 U.S.C. § 3502(3)(A)(i).

97 5 U.S.C. §§ 605(b) (certification requirement), 603(a) (initial regulatory flexibility analysis requirement).

98 MSRB Regulatory Notice at 13.

99 *Compare* SEC Municipal Report at 35 n.194 ("The Staff understands that the MSRB's EMMA website has received over 20 million page views per year, and the MSRB is forecasting over 25 million page views in 2012."), *and* MSRB, 2008 Fact Book at 1 (noting that EMMA had "put timely market information directly at the fingertips of retail investors" and "vastly improved on the information that retail investors could readily obtain"), *with* MSRB Regulatory Notice at 13 ("[U]sing EMMA to conduct the relevant pricing analysis

The benefits of the Proposals are acknowledged to be incremental given the amount of pricing information already available to retail investors.[100] In fact, the TRACE and EMMA information is more useful to retail bond investors than the disclosure specified in the Proposals, because the TRACE and EMMA data is available pre-trade, whereas some retail investors will not receive the proposed disclosure until approximately three days after the trade; the TRACE and EMMA data includes comparative data from multiple market participants, whereas the proposed disclosure includes comparative data from only one market participant; and the TRACE and EMMA data includes a rich data set of trade prices across time, whereas the proposed disclosure is largely a single data point. The MSRB has characterized the Proposal as one that simply would "provide investors with information generally already publicly available" on EMMA.[101] Accordingly, the resources that will be spent to comply with the Proposals, both initially and over time, would be better used to enhance retail use of TRACE and EMMA.

FINRA and the MSRB must include among the costs of the Proposal the funds that have already been spent on infrastructure and maintenance of their price dissemination platforms that will not be used to accomplish the stated objective. Since 1994, both FINRA and the MSRB have pursued long–range plans to design, build, maintain, and enhance centralized platforms for the dissemination of pricing information to retail investors. Any number of rule proposals and fee assessments since 1994 have been justified on the basis that these platforms would be enhanced over time to make an ever-increasing amount of price data available to investors electronically and free of cost in lieu of alternatives such as mailings or confirmation disclosure.[102] FINRA and the MSRB also need to compare the incremental benefit of the Proposals given the existence of pricing data available through TRACE and EMMA, to the total cost of the Proposals, as well as to the alternatives that may be available to enhance retail investors' use of TRACE and EMMA.

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requires that customers actively seek out information and make inferences as to which transactions are most relevant. Conducting this type of pricing analysis places a burden on customers.").

[100] MSRB Regulatory Notice at 13 ("Currently, retail customers may use EMMA to gain insight into the market for the securities they trade by viewing recent trade prices in the same or similar securities in similar quantities.").

[101] MSRB, 2014 Annual Report at 6.

[102] For example, the MSRB justified the substantial costs associated with EMMA by its contemplated use as the primary price dissemination vehicle for retail investors. *See* MSRB SR-2009-02 (Mar. 29, 2009), at 59 (stating that the MSRB "believes that the benefits realized by the investing public from the broader and easier availability of disclosure and price transparency information in connection with municipal securities that would be provided through the EMMA primary market disclosure service and EMMA trade price transparency service would justify any potentially negative impact on existing enterprises from the operation of EMMA.").

FINRA and the MSRB must also explain why they did not entertain alternatives that would make greater – and perhaps more innovative – use of TRACE and EMMA. For example, the MSRB has published plans for "free public user accounts" that would allow investors to "manage EMMA alert settings."[103] Presumably these accounts and alert settings would operate in a similar fashion to push notices that are commonplace and accessible on a variety of electronic devices. Neither FINRA nor the MSRB has explained why investors could not receive alerts of the sort currently proposed using this type of user account based on existing trade reports. Millions of bank depositors and credit card customers sign up to receive customized alerts on a daily basis. And neither FINRA nor the MSRB has explained why TRACE and EMMA could not be designed to send to interested investors emails with trading data by CUSIP, or be designed to allow firms to deliver to customers simple, one-click hyperlinks to access CUSIP-specific trading information.

C. The Costs and Burdens Associated with Implementation and Compliance Would Far Outweigh the Potential Benefits.

Although neither FINRA nor the MSRB appear to have performed any analysis of the actual costs of system enhancement necessary for the proposed disclosure requirement, the most recent SEC-required amendments to Rule 10b-10 disclosures for certain mutual fund distribution fees included a detailed cost-benefit analysis. In order to implement that requirement – which was far less complicated than the Proposals and did not involve the design of matching algorithms – the SEC estimated that clearing firms alone would incur one-time burdens in excess of $180 million and that total one-time burdens would exceed $258 million.[104]

Substantial system enhancements would be required of introducing firms, clearing firms, and vendor licensors of front-end systems to implement the Proposals. The costs would be disproportionately high for small and regional broker-dealers with limited bond trading operations or with overwhelmingly institutional customer bases. These entities compete with larger multi-service firms that may be better able to absorb the costs of infrastructure development and maintenance. Based on discussions with SIFMA member firms, preliminary assessments classify the work required by the proposals as requiring a large information technology project involving high complexity. Preliminary assessments suggest costs limited to firm-specific technology for introducing firms would range from $500,000 for a smaller firm to as much as $2.5 million for large diverse organizations. Preliminary assessments suggest that clearing firms may need to expend in excess of 5,000 man hours. Clearing firms would need to alter point of entry systems to accept two new fixed fields; enrich the fields and add them to the trade record in accordance with all other trade facts to be published downstream; enable confirmation systems to acknowledge the new fields, using either

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[103] MSRB, Long-Range Plan for Market Transparency Products (Jan. 27, 2012) at 8.

[104] Mutual Fund Distribution Fees; Confirmations, 75 Fed. Reg. 47,064, 47,126 (Aug. 4, 2010).

pre-formatted locations or trailer fields; modify corrections processes to permit correspondent firms to view and correct the new fields; and update daily activity reports to include the new values and fields. Although SIFMA does not currently have assessments from front-end vendor licensors, their costs are very likely to be substantial as well in light of experience with prior modifications to address regulatory reporting requirements.

The claimed benefits are acknowledged to be incremental[105] and less desirable[106] to increased use of TRACE and EMMA by retail bond investors. Neither FINRA nor the MSRB have evaluated alternatives that may achieve greater use of TRACE and EMMA by those "who may not know of EMMA or may not have the time or wherewithal to conduct their own transaction research" but who are nevertheless presumed to benefit from the proposed disclosure.[107] As discussed above, the cost of even a modified proposal limited strictly to riskless principal transactions significantly outweighs the purported benefits – something found repeatedly by the SEC in prior rulemakings.

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[105] *See, e.g.*, MSRB, 2014 Annual Report at 6 (acknowledging that the Proposal "would provide investors with information generally already publicly available" on EMMA).

[106] Confirmation of Transactions, Exchange Act Rel. No. 34962, 59 Fed. Reg. 59,612, 59,616 ("Price transparency [through TRACE and EMMA], if fully developed, will provide better market information to investors on a timely basis . . . .").

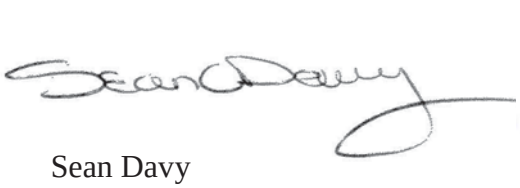
[107] MSRB Regulatory Notice at 7; *see also* FINRA Regulatory Notice at 2 ("Although knowledgeable industrious customers could observe these trading patterns retrospectively using TRACE data, our understanding is that retail customers do not typically consult TRACE data.").

CONCLUSION

SIFMA thanks FINRA and the MSRB for the opportunity to comment on the Matched Trade Proposals. SIFMA fully supports the objective to enhance bond market price transparency by putting more information into the hands of retail investors. To this end, SIFMA urges FINRA and the MSRB to withdraw the Proposals in favor of an approach that directs retail investors to the extensive pricing information available free of charge on TRACE and EMMA. As formulated, the Proposals risk confusing retail investors, present unworkable challenges in application, and threaten burdensome operational challenges while imposing unjustified costs and burdens than alternatives that would embrace TRACE and EMMA. SIFMA believes that – if FINRA and the MSRB were to require a new confirmation disclosure obligation with specific price references – alternative formulations would better accomplish the desired regulatory objective. Nonetheless, the enormous costs and burdens associated with even these alternative formulations significantly outweigh the purported benefits. Finally, SIFMA notes that nothing in the Proposals suggests that FINRA or the MSRB have conducted an adequate cost-benefit analysis as required under federal law and their own policies. The astronomical costs and burdens associated with implementation and compliance with the Proposals far outweigh the unproven benefits.

SIFMA welcomes the opportunity to discuss the Proposals, SIFMA's comments, and the various alternatives that would best serve our shared objectives. If you have any questions, please do not hesitate to contact the undersigned or Paul Eckert and Bruce Newman, SIFMA's outside counsel at Wilmer Cutler Pickering Hale and Dorr LLP, at (202) 663-6000.

Respectfully submitted,



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DIAMANT
INVESTMENT CORPORATION

Comprehensive Portfolio Management

January 9, 2015

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

RE: FINRA Proposed Ruling 14-52

Dear Ms. Asquith,

Diamant Investment Corporation (Diamant) is making the below constructive comments regarding the above proposed ruling detailed in the FINRA Proposed Ruling 14-52 (Proposal). The reason for making these comments is that is after reading the text of this proposed amendment, it became clear that FINRA, a regulatory authority charged with creating rules for the corporate bond industry, is demonstrating excessive regulatory overreach to a properly functioning bond marketplace, with little regard or understanding of the damages the Proposal will have for the very retail customer they are claiming to help.

The Corporate Bond Business

Diamant is a small, self-clearing, bond dealer that has been in business for over 40 years serving the investment needs of retail investors. I have developed considerable expertise in the retail bond business, having worked full time at Diamant, our family owned business, for over 36 years. Although the Proposal was clearly written by articulate policy makers and lawyers, it is also clear they have a near complete lack of understanding of the way bonds trade.

In the fixed income marketplace, business is conducted in large, but imperfect auction market. It is an auction marketplace that is dependent on bids and offers from a diverse group of bond dealers that position bonds for future sale. In the corporate bond market, bonds are not fungible, many CUSIPS trade infrequently (i.e. are not actively traded), and there are different characteristics between bond issues. There are complexities in locating and evaluating fixed income bonds that do not exist in other markets.

This auction market for fixed income bonds is completely different than transactions in the stock market. In the stock market, as little as 5,000 stocks trade in a manner where the same CUSIP can be traded on any given day in the year. With stocks, a customer order can be directed and executed on a listed stock exchange in a riskless agency transaction. It is important to recognize that bonds simply do not work this way. This is all pretty basic stuff, but apparently this point was missed when someone thought it would be novel idea to effectively treat corporate bond trading just like a riskless agency transaction.

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Diamant predominantly conducts a risk business in the fixed income sector, and does not employ a sales force to sell bonds. I must admit admiration of bond dealers that have a sales force that enables the trading of bonds in the same day they are purchased. This happens when a trading desk acquires an attractively valued bond, and the sales force is immediately able to locate customers to buy this bond. It happens frequently in the bond industry, yet the tone of this Proposal is that it is now bad that salespersons are pouncing on investment opportunities for their customers.

Although it is possible certain bond dealers may have a customer order in hand and are executing it in what seems like a riskless manner, it is also possible that trades are occurring in a normal auction place, where a trader has built a bond position in their firm inventory, and the sales force are able to quickly locate customers to purchase the bond, perhaps within a very short time frame. A short time frame does not always suggest such a trade is riskless, but rather that the sales team is very good at their job of selling bonds.

Despite the use of computers and various bond listing systems, the bond industry remains a fragmented auction market place where large bond dealers, mid-size bond dealers, and small bond dealers all co-exist, with each type of firm providing strength to a part of the market place. Just because this industry remains an auction market does not mean the current system is broken, or needs further regulatory interference in the guise of helping the customer.

Distinguishing Between Institutional and Retail Customers

In the corporate bond market, both institutional and retail investors participate in this auction market. There is no marker that distinguishes institutional from retail investors. The Proposal incorrectly assumes the existence of a qualifying size, where transactions above a 100,000 par value are all institutional customers, and trades below this threshold are all retail customers. This is a very simplistic and arbitrary threshold that does not apply in this complex marketplace. Certain retail customers may buy or sell bonds above a 100,000 par value. And certain institutional customers may buy or sell bonds below a 100,000 par value, perhaps to add or reduce an existing position. At times a retail customer may buy a bond, and the seller is an institution. At other times an institutional customer may buy a bond, and the seller is a retail customer. The important takeaway is that retail and institutional customer trades are intertwined together in the auction marketplace, and there is no bright line of a 100,000 par value to separate the two. Thus this Proposal will impact both institutional and retail investors. To use the proposed threshold of a 100,000 par value, or any other artificial device to separate or identify a qualifying size in such a complex market, is totally inaccurate. And as there is no bona fide threshold in the market, the negative impacts to retail investors from this Proposal will also spread to institutional investors.

Recent Comments By The SEC

On page 148 of the July 31, 2012 Report on the Municipal Securities Market by the SEC, there is a recommendation that the MSRB should consider requiring disclosure to customers of any markup or markdown. This report does not require FINRA get involved in the municipal bond industry regulation, as this is mandate of the MSRB. This report is about the separate municipal securities

market, not the corporate bond market. Although the SEC report makes for interesting reading, it is clearly regulatory overreach to presume the municipal bond report provides FINRA any mandate to change the corporate bond market.

The impetus behind this Proposal seems to focus on a June 20, 2014 speech that Commissioner White made where she referenced the need for markup disclosure. This speech had a laundry list of many topics. Although I admire the Commissioner, the particular topic that triggered this Proposal was not well thought out. Her intent was to probe overcharging in some trades, but I firmly believe she was looking for a way to improve, not destroy, the retail corporate bond industry. Her comments on this issue were:

> "This information should help customers assess the reasonableness of their dealer's compensation and should deter overcharging. The need for markup disclosure is increasingly important as riskless principal transactions become more common in the fixed income markets."

The immediate question raised is whether overcharging is actually occurring. FINRA has many years of data on every corporate bond trade that occurs, and FINRA also conducts substantial audit work on the reasonableness of bond dealers compensation. By now it would seem reasonable to conclude that FINRA knows if overcharging is commonplace. And if so, which bond dealers have a pattern of what may seem like overcharging, and what the circumstances are behind each trade. It would seem rather straightforward to focus regulatory efforts on questionable trades and further review instances where overcharging may occur.

There is a lot of detail that went into preparing this Proposal. FINRA has observed that 60% of retail sized trades had corresponding principal trades on the same day. This is very interesting to learn. But now knowing that 40% of these retail sized trades do not have corresponding principal trades on the same day, and that 60% of retail sized trades do have corresponding principal trades, is only very interesting to learn. It does not indicate any violation of FINRA rules. It is also very interesting to learn the statistic that of the 60% of retail sized trades with corresponding principal trades on the same day, 88% occur within 30 minutes of each other. There is no indication, however, that the 88% of these trades harmed the customer.

FINRA also noted that many trades have markups within a close range, but that some significant outliers exist. One should always expect outliers in an imperfect auction marketplace, and one would also expect outliers to occur at the lower quantity trade amounts as the higher markup is covering the fixed costs of a trade. I am not advocating that all price outliers are acceptable, but one must acknowledge there may be circumstances as to why they occur in an auction marketplace.

What is most interesting is that after all this analysis, FINRA was unable to produce any statistical rationale that indicates that retail sized corporate bonds trades with corresponding principal trades on the same day are actually harming the customer. Surely there would have been some statistics in the years of FINRA reviews of the corporate bond industry to provide overwhelming justification to support the need for the Proposal. If there were excessive markups occurring in corporate bonds with any type of frequency, clearly FINRA would have presented such information. Although the topic of avoiding rampant overcharging is a noble cause, it is not an issue in the corporate bond market place.

My personal belief is it is wrong to overcharge, as the objective of this business is to provide quality bonds to valued retail clients at competitive yields so they return to buy more bonds. This simple philosophy has worked for many bond dealers like us for decades, and we really do not need a regulator to remind us of the need to take care of our customer.

Another important question raised is whether riskless principal trading is actually occurring. It is very easy to view historical data and make the arbitrary assumption that a same day trade between a dealer and a customer had no risk. However, at the point of the day when the bonds were not yet sold to a customer, the perspective of risk is different, as the bond dealer may not know for certainty whether a customer trade will occur. This introduces risk into the equation. Yet such trades are all being deemed riskless solely because it is easier for data compilation purposes. This means senior regulators are provided what may be inaccurate data from which to create policy statements that in turn attempt dramatic changes to the fixed income securities industry.

No Need For The Proposed Rule

In the section titled "Need for the Rule" in the Economic Impact Analysis on page 8 of the Proposal, the assertion is made that the need for this Proposal is because FINRA is concerned investors are limited in their ability to understand and compare transactions costs. Why is the need to understand and compare the transaction costs of a bond dealer important to a customer unless they plan on entering the bond business and become a bond dealer? Over the last several decades that I have been following the bond markets, FINRA has not reported a substantial pattern of pricing abuse within the corporate bond auction marketplace, and they would have already taken action to remedy such issues. So this Proposal is not based on a real problem with retail trades, but rather on an unproven premise that it would be somehow helpful for a bond dealer to provide a customer with the gross markup in certain bond trades. Without demonstrating a real need, FINRA is practicing regulatory overreach in creating rules to solve a problem that does not exist.

A Very Bizarre Line Of Reasoning

The tone of the Proposal is that markups are somehow bad. This presumption has little to do with "helping" the customer with confusing partial disclosure. It has the feel of a politically driven effort to penalize a business sector by attempting to eliminate profits in the fixed income bond business. Which industry will be next?

There seems to be a misguided belief that securities bond dealers can continue to operate in a compliant manner in an already heavily regulated industry; can add substantive additional compliance costs to attempt to adhere to this Proposal; can continue to risk capital to provide a supply of securities to their customers; and can provide associated ongoing investment securities services to their customers; all while earning little or any gross profit. This theory simply will not work in the business world.

The reasoning behind this Proposal is that by forcing disclosure of the gross trade profit of a bond dealer, customers will somehow be better informed about the characteristics of the corporate bond investment they are making. By itself this is a very bizarre line of reasoning that is not used in any other decision making in the purchase of either small or large ticket items. To illustrate just a few examples:

> When a customer purchases either a new or used car, they never see the gross profit that the car manufacturer and/or the car dealer is making, as their focus properly is on securing a piece of transportation that meets their needs.
>
> When a customer renovates or purchases a house, they never see the gross profit of the builder or the individual seller, as their focus properly is on whether the location and structure is suited to their needs for shelter.
>
> When a customer purchases food at their local supermarket, they never see the gross profit in each item in their cart, as their focus is on shopping in a convenient location for quality merchandise that meets their needs of nourishment.

In the corporate bond business, the retail customer needs the assistance of a professional to navigate the selection of available fixed income products. When a client buys corporate bonds, their most important decision points may include: the income stream (coupon); years until their principal is returned (maturity date); return on the investment (yield which presumably is competitive to other similar bonds); what events can cause the principal to be returned early and what is the impact (call price and yield to call); what happens to this investment when rates move (duration); what revenue streams secure the interest payment; what assets secure the principal payment; what other alternatives are available; whether this investment should be made now revisited at another time; and whether the bond fits into a customer portfolio. Successful fixed income investment decisions have always been made on these types of important information.

What makes this Proposal so bizarre is that FINRA now believes customers should focus their attention not on important information described above, but instead on the disclosure of a gross trade profit number that should not be terribly relevant to the overall decision to purchase a bond. Note within the Proposal, Examples 1 through 6 seem to be the cherry picked transactions of larger markups in very short time frames. It is hard to believe that the entire bond dealer community of the corporate bond industry trades exactly as shown in these six examples. If this is the new industry standard as suggested in the Examples, many bond dealers will join me in expressing surprise in the discovery that our markups have been too low. Nonetheless, finding out that the bond dealer in Example 1 had a gross trade profit of $1,000, or even $500, is not the mission critical piece of information in a decision whether to commit ~$51,000 to purchase a particular bond.

And if this gross trade profit appears on the confirmation that is received by the customer on or after settlement date, is the intent of this disclosure to permit customers to break trades because the gross profit was $1,000 instead or $500? If so, then any of the specific trades that meet the disclosure requirement will have to be considered as un-firm, or incomplete transactions that may have to be reversed sometime in the future. In the future, would it not be advantageous for a customer to review trades over the past six years of disclosure, select all the trades which declined in market value, and return the trades back to the bond dealer using the reasoning the gross profit was too high on the

selected trades? How would a regulator expect bond dealers to haircut their net capital for incomplete trades when the dealer does not know which trades may be returned in future periods? Clearly no bond dealer would ever want to sell bonds to customers with this type of liability.

Of course the regulatory reader will counter by saying the disclosure may force the dealer to cut its gross profit and therefore the customer is better served. One would expect this perspective from regulators who apparently have not purchased a portfolio of bonds or have not worked in the industry they regulate. The gross profit is what is used to pay for all the components that keep a bond dealer in business. It is important to understand the difference between the gross profit and the net profit. Despite seeing a gross profit, it is possible there may be little net profit in a trade. Attempting to explain a gross profit on certain trades, versus a net profit, will hinge on the linguistic ability of the legal counsel of each bond dealer. With good lawyers, bond trades will become an event that results in both misleading and confusing customers over an irrelevant decision point.

In the examples within the Proposal, the dealer could have made a lower gross profit. The salesperson would be compensated less to communicate with their customer, the firm would not bother holding inventory it is unlikely to earn a net profit on, and the trader will not bother wasting time reviewing the marketplace. Reducing time spent on a trade and the associated customer service beyond the trade will all have to be reduced if the gross profit is the new focus of how to buy a corporate bond.

For those trades that occur with a disclosure requirement, FINRA should expect that the customer will no longer receive the needed attention to the above critical decision points inherent in a trade, as FINRA disclosure may reduce or eliminate the gross compensation of a dealer to provide these tasks. Then both the customer and the regulators can focus on the least relevant decision point in a transaction. In this game, the regulator now believes the trade is better for the customer, even though the customer may now own the wrong bonds without knowing it. Of course suitability comes into play, but one should not expect much effort on this beyond papering a file, as the important parts of the bond purchase decision are removed in order to display a lower gross profit. When one takes a hard look at this Proposal, it will actually harm a retail customer's ability to navigate the bond market and build a good portfolio for their hard earned money.

Unintended Consequences

Any securities firm forced to report gross markups on some bond trade confirmations will certainly harm their customer relationships. The anger and confusion from retail customers' who receive this partial information on some bond trades but not others, without understanding how the fixed income auction market works, or the level of effort that went into the locating and acquisition of a specific bond, will boil over throughout the corporate and municipal bond industry.

FINRA believes this Proposal encourages communications between firms and customers. Human nature being what it is; customers will consider any markup number disclosed pursuant to this Proposal to be too large. Everyone should expect customers who are given disclosure of a gross profit number on a trade to be upset the number is not smaller. Any additional confirmation disclosure on selected trades will mislead and confuse retail investors, and this is exactly the type of communications

issues firms that one must expect as conversations move away from investing, towards mollifying customers.

Before the regulatory reader gets a smug sense of satisfaction, one needs to understand what happens next. If a confirmation disclosure from a corporate bond transaction is perceived to harm a customer relationship, most securities bond dealers will simply stop trading corporate bonds. Wall Street is full of smart people who will find some other way to service their customers fixed income needs without dealing in specific corporate bonds.

Most bond dealers enjoy their own client base that has been cultivated over time. Because of the complexities of buying bonds which are not fungible and may not available at other bond dealers, these purchases are not shopped between bond dealers. Each firm provides an investment experience that its clients seek, at a service level which may differ from other bond dealers. Under this Proposal, a low volume firm with a small sales force will likely have few, if any, disclosures to make on their confirmations, as they may not trade the same CUSIP within a day. Bond dealers with high trading volumes may trade the same CUSIP within a day, and will have disclosures on many of their confirmations. Thus some bond dealers are forced to disclose, while others are not. From a pure economic perspective, the firm making disclosures is at an artificial competitive disadvantage to the firm that does not need to make disclosures.

How To Harm Retail Customers

The best way for FINRA to harm retail customers is to proceed exactly with this Proposal. FINRA will celebrate achieving disclosure not seen in other industries, and then will wonder why the bond dealer community stopped handling retail customer trades. What a brilliant disaster.

How can the retail customer be harmed with this disclosure? First of all, corporate bonds will stop trading at many if not all bond dealers. Why would any bond dealer want to effect trades that antagonize their relationship with their customer, and create unknown liabilities of future trade cancellations, regardless whether such trades provide great value to their clients? If this Proposal is implemented, my immediate response will be to prohibit trading any corporate bonds from or to retail customers, for any bond that meets the disclosure definition under this Proposal. Not only would customer relationships be harmed, but the additional compliance costs would be excessive for just these specific types of trades. Many other bond dealers may arrive at the same conclusion. The harm is that the retail investor will be denied liquidity in what remains of the corporate bond marketplace.

Second, from an operational perspective, FINRA must understand that bond dealers are unable to comply with identifying selected transactions without incurring substantial costs to back office operations. It will be easier to create a firm wide immediate stop trading system on a CUSIP before or just after a retail customer trade occurs, than to monitor all trade volume before or after the retail trade occurs. Even if a firm does not expect to have to make disclosure, they will have to have both a back office and compliance system in place to identify transactions that meet this Proposal and then process such trades in a manner completely different than other trades. Who thought this was a good idea?

It is completely naive to think that every firm just waves a magic wand to achieve instant compliance with a rule that will be very difficult to comply with, even at a low volume dealer. Compliance costs will be very significant to create a separate purchase and sales module to existing back office systems to identify applicable trades and then create a substantive, unique disclosure document on selected confirmations. This process will delay the sending of such trade confirmations as there will have to be a completeness check on all impacted confirmations prior to mailing, and an internal audit function to assure that every bond transaction that meets certain eligibility is part of this exception processing. These additional processes and reviews will likely delay the batch production and mailing of all securities confirmations for that trade date until the broker dealer is confident the confirms that need disclosure have been properly prepared.

As this has never been done before, we do not have a hard data processing quoted cost to achieve this. If we were to create a new automated separate purchase and sales module to integrate within our legacy back office system, we would likely have to start with a budget in the $50,000 to $100,000 range. For our size firm, it would take a minimum of three years of diverting all net trading profits from corporate bonds to cover this cost. This simply is an unworkable solution, which is why I would be forced to institute a stop trading process to avoid effecting any retail trades that fit the final definition of the Proposal. If is fair to conclude that internal stop trading rules designed solely to avoid this Proposal will not in any way "help" the customer.

Alternatives To This Absurd Proposal #1- Internal Regulatory Rules

If FINRA is fixated on same day gross profit disclosure, then let the bond dealers create their own sets of rules on how to handle trading in manner that avoids all disclosure. The way to achieve this is to make sure the bond dealer only completes one principal trade to a retail client in any particular CUSIP for any particular trading day. Should a firm trade a CUSIP in the morning to a retail client, they would have to stop bidding or trading this bond throughout the remainder of the day. Conversely, if that CUSIP had traded somewhere else in their firm during that day, the firm would also need to modify its systems to refuse to sell these bonds to a customer by creating an internal stop trading system. In this manner, even though the customer may want to purchase a particular bond which really fits the customer's investment needs, they may not be able to buy the bond due to a regulatory time delay. And if a customer needs to raise cash immediately, in this environment they will have to understand there is now a regulatory time delay in their sale. This regulatory time delay is the direct result of such a naive Proposal, but it is a workable solution for the dealer community.

Aside from a regulatory time delay, what happens to the auction marketplace as bond dealers create their own sets of trading rules to comply with this Proposal? After this Proposal is implemented, the last thing a bond dealer will want is to inadvertently buy bonds in the same day a customer purchased bonds. So bond dealers will need to change all their Street bids as being subject to being pulled at any time. Instead of firm bids, the marketplace will be working with un-firm bids that really just are indications of where bond dealers might want to buy a bond if no other trades occur in the bond that day at their firm.

With un-firm bids, the auction market in corporate bonds ceases to function properly. As an illustration of un-firm markets, I will always remember how the stock market quotes were un-firm

when the equity markets were having difficulty functioning during the stock exchange market crashes of 1987, 1998, 2002, and 2008. One does not need a vivid imagination to understand what happens in an auction marketplace when rates move and the bidding bond dealers who understand the bonds refrain from bidding due to this new rule. Large spreads would be commonplace, assuming a bona fide bid materializes. This substantial market impact will be a direct result of this Proposal.

Alternatives To This Absurd Proposal #2- Time Period

If FINRA has already decided to proceed with this Proposal prior to reading industry comment letters, then modify the time period for disclosure between offsetting trades in a CUSIP to be within 30 minutes of the first trade. The statistical work in the Proposal infers that almost all retail customer trades deemed "riskless" (88% of 60%) occur within 30 minutes of each other. So let's use this data driven benchmark as the true definition of "riskless". This way reference prices are easily identifiable as back office operations can now identify adjacent trades that would need disclosure, while permitting corporate bond dealers to continue to operate in the marketplace during the rest of the day without triggering inadvertent disclosure. Moreover, back office enhancements can be designed in a much more cost effective manner if they focus on adjacent transactions within 30 minutes instead of the entire trading day. In this scenario, bond dealers may actually be able to afford the additional compliance costs. And the auction marketplace could continue to function with a workable new set of rules. This alternative should dovetail in with what seems like the Proposal's premise to display the gross profit of all riskless trades that are occurring in the very short time frame. This alternative does not suggest that with my decades as a seasoned industry veteran, that I have any understanding why this Proposal is a good idea for customer relationships, but at least it will provide near real time reporting of "riskless" trades for regulatory review, and provide for accurate manual procedures of identifying in back office operations the specific confirmations that need special handling and processing.

Alternatives To This Absurd Proposal #3 - Exclusions

If FINRA has already decided to proceed with this Proposal prior to reading industry comment letters, it would be prudent to include exclusions for certain types of transactions notwithstanding the fact they are retail sized transactions. In addition to excluding institutional investors, the Proposal should also exclude entities that act with institutional type knowledge. This should include banks, trust companies, and registered investment advisors that are employed by individual and institutional customers to invest their portfolios and make transaction decisions on behalf of their customers.

Alternatives To This Absurd Proposal #4- No Action

After reviewing the Proposal and alternatives, FINRA needs to recognize this Proposal will do more harm than any good. The disclosures will clearly mislead and confuse retail investors to a degree that cannot be remedied by education, explanations, or descriptive documents accompanying a confirmation.

The auction marketplace has many intertwined industry participants that include retail customers; institutional customers; corporate bond dealers that trade mainly with other corporate bond dealers; and corporate bond dealers that trade mainly with their customers. All these participants within this large auction market will be adversely impacted. The noteworthy harm will occur to retail customers that will be unable to trade bonds on days that their bond dealer decides not trade their CUSIP, in order to avoid disclosure of this Proposal. The larger harm will come from the auction marketplace no longer having liquidity. This occurs from the absence of firm bids as bond dealers stop trading bonds that would trigger the disclosure in this Proposal. These are terrible, yet very realistic outcomes from this Proposal.

Harming the relationship between the customer and the bond dealer, and having bond dealers reduce or eliminate retail trades, all for the sake of this misguided Proposal, simply does not add any benefit to the retail customer.

In this reasonable alternative, FINRA must simply recognize the complexity within the entire fixed income marketplace, review the alternatives, and commit to taking no action on the entire Proposal.

Conclusion

While on the very surface the Proposal seems a noble idea, as shown throughout my response, it actually opens up issues that are uncontrollable in terms of damage to the fixed income auction markets. Moreover, the Proposal is trying to solve problems that do not exist. Most customers are being treated fairly by the markets. So there is no reason to run a regulatory wrecking ball through a working auction marketplace in a manner that destroys capitalism, impairs retail customer access to markets, and impairs or shuts down bond firms. The conclusion must be that FINRA thoroughly reviewed the matter in a meaningful way, but after careful consideration of the unintended damage to the marketplace, decided to take no action in order to continue maintaining an orderly and regulatory compliant market in corporate bonds.

Yours truly,

Herbert Diamant
President

December 30, 2014

Ms. Cynthia Friedlander
Director
Fixed Income Regulation
FINRA

By email

Dear Ms. Friedlander:

I am a student of the securities markets, not a securities professional. However, I have taught various securities test preparation classes in the past.

The proposed FINRA rule, *Pricing Disclosures in the Fixed Income Market*, (Notice 14-52), requires disclosure of the price paid or received by a member on a principal transaction, as well as the price that the customer pays or receives. As I understand it, the rule applies in cases where trades are effected on the same day, and the size of the order ("qualifying size") is for 100 bonds or less, or the trade is for $100,000 or less in face value. The intent of the rule, as I understand it, is to provide retail customers with full disclosure, not only how much they pay or receive on bond transactions, but also how much is paid or received by the member firm acting as principal on the trade, where the trades are effected on the same day.

I agree with the thrust of FINRA's proposed rule, especially that disclosure of a member's price on a bond trade to a retail customer should not be limited merely to riskless transactions.

However, I have a problem with the limited scope of the FINRA rule, specifically regarding qualifying size. For example, why limit disclosure only to trades involving 100 bonds or less? I argue that price disclosure on principal trades should be made on all bond trades involving retail customers, with no limit in qualifying size, provided that the customer is truly retail, and not a broker/dealer or other institutional investor.

Consider this example. Grandma Jones has just received $5 million insurance proceeds upon the death of her husband. Grandma Jones knows nothing about the stock or bond markets. Her representative at ABC Brokerage suggests that she put all $5 million in XYZ Corp. bonds. On the basis of this advice, Grandma Jones agrees to do this. ABC Brokerage goes out and buys $5 million XYZ bonds at 95, and then 10 minutes later, sells the bonds to Grandma Jones at 100. In this case, I submit, FINRA should require disclosure, notwithstanding the number of bonds exceeds 100. Grandma Jones is a quintessential retail customer.

I argue, she has, as a retail investor, a right to know how much she is being charged, and whether ABC Brokerage and her representative are taking advantage of her. My same argument applies to transactions whose face amount exceeds $100,000. There should be full disclosure of the member firm’s profit on all retail trades, notwithstanding that they exceed $100,000 in face value. After all, we are talking about protecting unsophisticated retail bond customers. They deserve to receive full disclosure of the member's price. This disclosure should not hinge on whether the retail trades are for 100 bonds or less, or the face value size is $100,000 or less.

Also, in reference to FINRA’s examples 11, 12, and 13 in Notice 14-52, where some trades occur on previous days, I argue that FINRA should not limit required disclosure to trades occurring on the same day, but require disclosure for all principal trades involving bonds sold to retail customers which are effected within the five previous trading days. Why? Consider this example. Andy, a representative, learns that Widow Helen has just received an inheritance of $10 million. He talks with Widow Helen and urges her to put the monies into 20 different bond issues. Widow Helen tells him that she needs a few days to think it over, but that she probably will follow his advice. Andy returns to his firm and tells his manager of Widow Helen's probable intentions. In anticipation of the likely forthcoming retail order, Andy’s firm goes out and purchases $10 million in the bond issues that Andy recommended. The firm's average cost for these bonds is 99. Three days later, Widow Helen places her buy order. Andy’s firm sells Widow Helen $10 million bonds for 100. I submit, a trade like this should also be covered by FINRA's disclosure rules. Andy’s firm should not be allowed to keep its cost basis secret. Widow Helen, as a retail customer, has a right to full disclosure—to know how much Andy’s firm has paid versus what the firm is charging her.

In the first of the above examples, retail customers place orders for more than 100 bonds or for more than $100,000 in face value. In the last case, the firm’s purchase is effected several days before the retail customer places her order. Under the present proposed rule, FINRA's disclosure rules would not apply. I argue, FINRA's rule should offer protection to these retail customers too.

I believe it is bad policy as well as bad business practice for member firms to conceal their costs from retail customers on bond transactions effected on a principal basis, whether in buy or sale trades. In summary, I argue, FINRA should not limit the proposed disclosure rule just to trades for 100 bonds or less, or to trades $100,000 or less in face value, or only to trades effected on the same day.

Robert A. Eder Sr. J.D.
2585 East 4510 South
Salt Lake City, UT 84117

801-707-9985
hussein.eder@gmail.com

Sir:

I am a student of the securities markets, not a working professional. I have taught securities test preparation classes in the past. I agree with the general thrust of FINRA's proposed rule (Notice 14-52) on Pricing Disclosures in the Fixed Income Market, which requires disclosure of the price paid or received by the member in a principal transaction and the price that it charges to the retail customer, when trades are effected same day, and the size of the order is for 100 bonds or less, or for $100,000 or less in face value.

However, I don't agree that disclosures should be made only for 100 bonds or less. I argue that disclosure should apply to all bond trades, no limit in the size. Why? Consider Grandma Jones who has just received $5 million insurance proceeds upon the death of her husband. Grandma Jones knows nothing about the stock or bond markets. Her representative suggests that she put all $5 million in XYZ bonds. Grandma Jones agrees to do this. The member firm goes out and buys $5 million XYZ bonds at 95, and then 10 minutes later, sells the bonds to Grandma Jones at 100. In this case, FINRA should require disclosure, notwithstanding the number of bonds exceeds 100. I say, Grandma Jones has a consumer's right to know how much she is being charged, and whether the firm is taking advantage of her. The same logic applies to where the size of the transaction exceeds face value of $100,000. There should be full disclosure of the member firm's profit. After all, we are talking about unsophisticated retail customers. They deserve full disclosure.

Also, in reference to FINRA's examples 11, 12, and 13, where some trades occur on previous days, I argue that FINRA should not limit required disclosure to trades occurring on the same day, but require disclosure for all firm principal trades done within the previous five trading days. Why? Consider this example. Andy, a representative, learns that Widow Helen has just received an inheritance of $10 million. He talks with Widow Helen and urges her to put the monies into 20 different bond issues. Widow Helen tells him she needs a few days to think it over, but that she probably will follow his advice. Andy returns to his firm and tells his manager of his conversation. In anticipation of the probably forthcoming retail order, Andy's firm decides to go out and purchase $10 million in the bond issues that Andy recommended to Widow Helen. Its average price for these bonds is 93. Widow Helen then places her order three days later. Andy's firm sells her $10 million bonds for 100. Andy's firm should not be allowed to keep its cost basis secret. Widow Helen has a consumer's right to know how much Andy's firm paid versus what the firm is charging her.

In the first two of the above examples, retail customers place orders for more than 100 bonds or for more than $100,000 in face value. In the last case, the firm's purchase is several days before the retail customer places her order. FINRA should attempt to protect these retail customers also. I believe it is bad policy and bad business practice for member firms to conceal their principal prices on bond transactions, whether in buy or sale trades, from their retail customers. In summary, FINRA should not limit this disclosure rule just to trades for 100 bonds or less, or to trades $100,000 or less in face value, or to trades effected on the same day.

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Disclosing all pricing information on retail accounts doesn't sound like a good proposal. The smaller the trade , the more a representative may have to mark up the position to cover clearing charges, etc. If exposing any pricing on confirms, it should be the larger trades of maybe 500M or more. Just my thought!

Thanks!

OFFICE OF THE
INVESTOR ADVOCATE

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

January 20, 2015

Submitted Electronically

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

RE: Regulatory Notice 14-52
Request for Comment on Pricing Disclosure in the Fixed Income Markets

Dear Ms. Asquith:

Pursuant to Section 4(g)(4) of the Securities Exchange Act of 1934, the new Office of the Investor Advocate at the U.S. Securities and Exchange Commission is responsible for analyzing the potential impact on investors of proposed rules of the Commission and self-regulatory organizations ("SROs"). More broadly, we are also required to identify areas in which investors would benefit from changes in the existing regulations of the Commission or the rules of SROs. In furtherance of these objectives, we will routinely review existing rules and rulemaking proposals of the Financial Industry Regulatory Authority ("FINRA"). We will make recommendations to FINRA from time to time, utilizing the public comment process when appropriate. In addition, as required by Section 4(g)(4)(B), we will report to Congress on the actions taken in response to our recommendations.

We are pleased to have this opportunity to submit comments regarding FINRA's proposed rule requiring firms to disclose additional information on customer confirmations for transactions in fixed income securities, as described in Regulatory Notice 14-52 (the "Notice").[1] In short, we support FINRA's effort to increase price transparency for retail customers, and we urge you to adopt the proposed amendment to Rule 2232.

The Notice details FINRA's proposal to require disclosure on customer confirmations of same-day pricing information for retail size transactions in certain fixed-income securities. The Notice states that 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." We agree.

Naturally, steps to improve price transparency will benefit individual investors. Although individual investors already receive some of the information at issue and have access to FINRA's Trade Reporting and Compliance Engine ("TRACE") data and trading histories from various internet sources,

[1] The comments provided in this letter are solely those of the Office of the Investor Advocate and do not necessarily reflect the views of the Commission, the Commissioners, or those of any other Office, Division, or Commission staff. The Commission has expressed no view regarding the statements of the Office of the Investor Advocate expressed herein.

customer confirmations are not currently required to include information about the cost of the security to the firm.[2] Nor is it easy for individual investors to determine the value of a security using the publicly available information. By requiring firms to disclose the price of the offsetting trade and the differential between these prices when the offsetting trade is within the same trading day, customers in retail-size trades would likely be better equipped to evaluate the transaction and the quality of service provided to them by a firm. This information may also have a preventative effect because firms will be less likely to charge excessive mark-ups when the price differential must be disclosed so clearly, and customers and FINRA will likely detect improper practices more easily as a result.

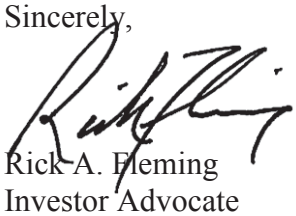
Question 5 of the Notice asks whether the objectives of the proposal would be achieved if a firm is required to disclose the price paid or received by the firm in a transaction with a third party, without disclosing the actual differential between that price and the price in the customer transaction. In other words, should the firm be required to show the calculation on the confirmation to reveal the difference between the prices? We urge FINRA to keep this requirement, as it is much easier for the firm to automate this calculation than to place that burden upon investors.

Question 8 of the Notice seeks comment on whether the disclosure should be subject to a *de minimis* standard, where disclosure would not be required if the price differential is small. In our view, it is important for investors to know the pricing information, even when they are receiving a good price, and this information helps them put into context the transactions in which the pricing differential may be excessive.

The Notice posits potential regulatory alternatives 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. As an alternative, the Notice suggests that one possible approach would be to limit disclosure of pricing information to "riskless principal" trades only. FINRA believes that there are increased benefits to requiring disclosure for all trades rather than limiting disclosure to only riskless principal trades, and we agree with that conclusion. Although the alternative approach would provide a degree of price transparency, we support the adoption of the proposed amendment because of its more all-encompassing reach. We also note that the proposed amendment provides firms with a relatively clear and standardized approach to disclosure, as compared to the alternative riskless principal approach.

In conclusion, we applaud FINRA's efforts to improve price transparency in fixed income markets. We also appreciate the collaborative and cooperative manner in which FINRA has worked with the MSRB to achieve consistent goals. Your significant efforts will impact post-trade price transparency for individual investors, and we encourage you to continue to make advances not only in post-trade price transparency, but also in pre-trade price transparency. Should you have any questions, please do not hesitate to contact me.

Sincerely,



Rick A. Fleming
Investor Advocate

[2] Securities and Exchange Commission, Report on the Municipal Securities Market, at 147, July 31, 2012, http://www.sec.gov/news/studies/2012/munireport073112.pdf.

Via PDF email: pubcom@finra.org

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

January 7, 2015

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

Dear Ms. Asquith:

The members and management of DelphX LLC [1] ("DelphX") appreciate this opportunity to respond to the request for comments issued by the Financial Industry Regulatory Authority ("FINRA") in Regulatory Notice 14-52 (November 2014). We are pleased to submit the following comments regarding FINRA's important and timely proposal to increase transparency relating to transactions involving fixed income securities ("Proposal"). The Proposal would "require customer confirmation disclosure of same-day pricing information for customer retail-size transactions in corporate and agency debt securities."

As reflected in many recent commentaries, pre-trade pricing and transaction costs in the vast fixed income market continue to be opaque.[2] This lack of transparency materially limits the ability of investors to discern the remuneration retained by their broker-dealers in fixed income trades,[3] and investors' ability to determine if their broker-dealers fulfilled their obligation to seek the "best execution" of such trades.

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[1] DelphX is an unbiased pricing-service provider dedicated to promoting efficiency, liquidity and broad pre-trade price transparency for corporate bonds and other fixed income securities by delivering validated continuous forecasts of the price at which each such security would currently trade. The undersigned, Larry Fondren, is the founder and CEO of DelphX. For more information about Larry Fondren, please visit http://en.wikipedia.org/wiki/Larry_Fondren. For more information about DelphX, please visit www.delphx.com.

[2] See, e.g., Securities and Exchange Commission ("SEC") Chair Mary Jo White, "Intermediation in the modern securities markets: putting technology and competition to work for investors" (June 20, 2014), 5-6; SEC Commissioner Daniel M. Gallagher, "Remarks to the Georgetown University Center for Financial Markets and Policy Conference on Financial Markets Quality" (September 16, 2014), at 5-6; SEC Commissioner Michael S. Piwowar, "Remarks at the 2014 Municipal Finance Conference presented by The Bond Buyer and Brandeis International Business School" (August 1, 2014), at 4-5; Director of the SEC Division of Trading and Markets, Stephen Luparello, "Testimony on 'oversight of the SEC's Division of Trading and Markets'" (June 26, 2014), 6-7; FINRA Chairman and CEO, Richard G. Ketchum, at the FINRA Fixed Income Conference (March 9, 2010); Legislation: Mark R. Warner (D-VA) and Thomas A. Coburn (R-OK) sponsorship of "Bond Transparency Act of 2014," S. 2114, 113th Cong. § 3.

[3] Because fixed income securities transactions are commonly executed by broker-dealers which act as a principal in the transaction, their remuneration is generally secured in the form of a markup or markdown from the "prevailing market price." See FINRA Rule 2121. The Proposal is intended to address the fact that, currently, the amount of that markup or markdown is not required to be disclosed on the confirmation for fixed income trades executed by a broker-dealer as principal.

Based upon our experience and the insights received from an array of market participants, we believe there is a critical need for increased pre-trade price transparency in relation to transactions involving fixed income securities, particularly those issues that are traded infrequently. We, therefore, applaud FINRA's initiative to enhance fixed income market transparency for investors.[4]

A. Scope. The comments contained herein are principally focused on FINRA's request regarding alternative forms of disclosure or methods that would achieve or serve to better facilitate the objectives of the Proposal.

B. Summary of Comments. As discussed below, we believe the Proposal could provide useful information to investors that would enable them to make more informed investment decisions and be better equipped to assess the quality of their trade executions by broker-dealers. Moreover, in response to FINRA's request for "alternative forms of disclosure or methods to achieve the objectives of the proposal," [5] we believe that an additional means of providing transparency, namely, the recognition of "**Accredited-Benchmark**" prices that accurately forecast the current market price ("Market-Price") of a fixed income security continuously throughout each trading day, would provide timely and relevant pre-trade pricing information to investors. That contemporaneous information could be used by investors to assess the remuneration retained by broker-dealers when effecting their trades, and to evaluate the performance of broker-dealers in seeking "best execution" of those trades. We also believe that this approach of employing transparently-validated Market-Price forecasts would provide a comprehensive and cost-efficient means of expanding the scope of the Proposal to include customer transactions for which there is no same-day or recent transaction involving the subject security.

C. The Proposal. FINRA states that it is "concerned that investors in fixed income securities currently are limited in their ability to understand and compare transaction costs." [6] FINRA is proposing an amendment to FINRA Rule 2232 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."

> 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. The rule would define "qualifying

[4] As the Regulatory Notice notes, the Municipal Securities Rulemaking Board ("MSRB") has coordinated with FINRA and issued a similar proposal relating to transactions in municipal securities: MSRB Regulatory Notice 2014-20, "Request for comment on draft rule amendments to require dealers to provide pricing reference information on retail customer confirmations" (November 17, 2014).

[5] See, e.g., Regulatory Notice 14-52, Request for Comments, No.5.

[6] Regulatory Notice 14-52, at 8.

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.[7]

While this additional disclosure could "better enable customers to evaluate the cost and quality of the services firms provide," [8] it has a variety of limitations. Because many of these considerations are recognized and discussed in the Regulatory Notice, we touch upon them only briefly in our comments below.

D. Response to Selected Request-Questions.

We refer to specific requests for comment as numbered in the Regulatory Notice.

Question 1. What are the anticipated benefits to investors of providing the proposed disclosure?

Response: Economic studies have shown that investors benefit from increased price transparency through material reductions in their transaction costs.[9] Currently, broker-dealers are not required to disclose their markups or markdowns to investors on fixed income trade confirmations when the broker-dealer acts as a principal in the transaction.[10] Therefore, we believe additional relevant and meaningful information about current Market-Pricing would assist investors in understanding the remuneration retained by their broker-dealers, and help investors evaluate the services they receive. Providing pricing information relating to similar same-day trades, as the Proposal contemplates, could assist investors in assessing the quality of a broker-dealer's transaction services. However, we believe the alternative Market-Pricing information described in Section E below could further the Proposal's objectives, and materially enhance the scope of its benefit to investors.

Question 4. For which transactions should pricing disclosures be made?

Response: Useful and meaningful price disclosure should be made available, where feasible, for all forms and sizes of transactions, rather than be limited to retail-sized or "riskless principal" trades. Without meaningful pre-trade price disclosure, institutional investors are as uncertain as individual investors as to the current Market-Price of securities they are considering buying or selling. While it is possible that increased price-transparency may diminish the levels of traditional dealer-sourced liquidity, increasing the ability of investors of all sizes to more confidently assess the current Market-Pricing of securities will potentially increase investor-sourced liquidity and the ability of dealers to more-

[7] Regulatory Notice 14-52, at 3.
[8] Regulatory Notice 14-52, at 8.
[9] *See* Hendrik Bessembinder and William Maxwell, "Transparency and the corporate bond market," J. Econ. Perspectives, v.22, no.2 (Spring 2008), 217, 227 ("Overall, the statistical and anecdotal evidence indicates that the introduction of post-trade transparency in the corporate bond markets has significantly reduced the costs that investors pay to dealer firms for executing their trades in corporate bonds."); Amy K. Edwards, Lawrence E. Harris, and Michael S. Piwowar, "Corporate bond market transaction costs and transparency," J. Fin., v.LXII, no.3 (June 2007), at 2. "If transaction costs are a deterrent to retail interest, we would expect retail interest to increase with the lower transaction costs associated with transparency." Id. at 31.
[10] Regulatory Notice 14-52 n.9 (discussing SEC Rule 10b-10; also noting that FINRA rules 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").

readily facilitate "matching" or "pairing" of contra-trades among investors – further promoting increased liquidity.

Question 5. Are there alternative forms of disclosure or methods to achieve the objectives of the proposal and are they better suited than the proposal?

Response: We believe that, by creating an environment in which independent pricing-service providers are incentivized to develop and continuously publish precise forecasts of the current Market-Price of outstanding fixed income securities in real-time, investors would gain access to a transparent and demonstrably accurate means of assessing the current Market-Price of securities they are considering buying or selling. Such a transparent environment, as described more fully below, would also enable investors to independently assess the remuneration retained by their broker-dealers, and more efficiently determine the quality of executions they receive from their broker-dealers.

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?

Response: We believe the "best available representation of current market price" would be more useful and provide broader utility to institutional and retail investors, particularly in cases where contemporaneous transaction pricing is not available. The breadth of that utility will also likely increase in cases where no other transaction involving the security has occurred in the last day, week or longer.

The idea of providing investors with current Market-Price forecasts and other benchmark prices is not a new one. The need for investors to receive relevant information immediately prior to buying or selling a bond was recognized by the Corporate Debt Market Panel ("Panel") established by FINRA's predecessor.[11] The Panel stated that an important part of increasing investors' ability to "understand the detail of their investment choices, risks and return" is the "ability to link aspects of recent improvements in transparency with actual transactions so that individual investors can determine the quality of execution they receive from their brokers." [12] The recommended pre-trade information included "[w]here the customer can get information on recent transactions in this or similar bonds." [13] The Panel also observed that "it would be very helpful for investors to be able to compare the price and yield they receive for a bond against industry benchmarks." [14]

The Accredited-Benchmark utility described in Section E below would help investors realize many of the Panel's aspirations, by providing accurate to-the-second forecasts of the current Market-Price of thousands of fixed income issues, including those for which no contemporaneous transaction pricing is

[11] National Association of Securities Dealers, "Report of the Corporate Debt Market Panel," at 2, 9 (September 2004) ("Debt Market Panel Report").
[12] Debt Market Panel Report at 9.
[13] Debt Market Panel Report at 12.
[14] Debt Market Panel Report at 3.

available. It also would benefit investors by fostering a transparent market facility through which independent pricing-service providers are incentivized to publish the most accurate Market-Price forecasts possible, and to continually strive to improve the scope and cost-efficiency of their pre-trade pricing utilities.

Question 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?

Response: While some firms currently provide markup (markdown) information to their customers, we believe investors would materially benefit from broker-dealers including information regarding the current Market-Price forecasts of one or more Accredited-Benchmarks for the subject security. Accordingly, we believe that Rule 2232 should permit the inclusion of Accredited-Benchmark pricing as an acceptable alternative to the reference pricing disclosures discussed in the Proposal, particularly where same-day transaction pricing for the security is not available.

Question 9. 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?

Response: We believe it would be appropriate to allow member firms to establish their own methodology, consistent with the objectives of the Proposal, provided that methodology is developed employing an objective rationale acceptable to FINRA, is clearly described to investors and consistently applied in all transactions. For example, should a firm choose to display Accredited-Benchmark pricing in its confirmations, it would be required to implement written policies and procedures to: (a) identify the Accredited-Benchmark as defined by criteria in a FINRA rule; (b) use a consistent methodology to disclose the Accredited-Benchmark's Market-Price forecasts to customers; (c) periodically review the performance of the Accredited-Benchmark to verify that it continues to satisfy the accreditation criteria specified by FINRA and provides meaningful information to customers; and (d) retain all documentation and data required to demonstrate the foregoing. Member-firms could thus optionally disclose on customer confirmations the price to the customer, the Accredited-Benchmark price of the subject security at the time of the trade, and the differential between those two prices.

Question 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?

Response: As noted above, we believe a firm should be allowed to use an Accredited-Benchmark as the determinant of Market-Price at the time of each trade, and to consistently include such reference pricing in its confirmations. Given the transparency, validation and documentation of every Accredited-Benchmark price, the firm would have ready access to all documentation required to justify its use of Accredited-Benchmark prices. Use of objectively-derived Accredited-Benchmark prices would thus avoid the subjective pricing difficulty described in this question.

Question 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?

To provide additional transparency, we believe firms should be required to provide customers with an explanation of the pricing information they use (including Accredited-Benchmark prices) on trade confirmations, customer statements, and/or the firm's website.

E. Enhancing Pre-trade Price Transparency Through "Accredited-Benchmarks".

DelphX agrees with FINRA that investors in fixed income securities are currently limited in their ability to understand and compare transaction costs. However, we believe "understanding" and "comparing" are separate, but related, challenges. The Proposal would help with the former, but have limited impact on addressing the latter - as investors' comparative-pricing information would be limited to only the prices of same-day transactions executed by their broker.

Because the vast majority of outstanding corporate bond and other fixed income issues will likely not be traded on any given day, the transparency fostered by the Proposal will apply to only a small portion of the total universe of such securities. We believe FINRA's recognition of an additional form of pre-trade price transparency, which also encompasses the larger group of securities for which no readily-observable current transaction pricing is available, would expand the utility and benefit of the confirmation disclosure contemplated in the Proposal.

To provide that additional comparative-pricing information to investors, we propose that FINRA foster the development and ongoing refinement of historically-accurate, continuously-updating forecasts of the current Market-Prices for a broad array of fixed income securities, including those for which no recent transaction information is available. Specifically, we encourage FINRA to:

1) Establish an environment in which independent pricing-service providers are encouraged to calculate, validate and publish in real-time continuously-updating forecasts of the Market-Price at which each of a broad universe of outstanding corporate bonds, and other fixed income securities, would currently trade;

2) Prescribe a standard protocol for measuring the accuracy of such forecasts, and definitive qualification parameters, that all pricing-service providers could employ to uniformly determine the accuracy with which their Market-Price forecast for a subject security predicted the actual price at which that security traded ("Trade-Price");

3) Specify the minimum acceptable level of historical accuracy that the Market-Price forecasts published by a pricing-service provider must continually meet to qualify as an "Accredited-Benchmark"; and

4) Amend Rule 2232 to provide guidance to member firms, that the price of an Accredited-Benchmark is an acceptable reference source of the current Market-Price of the subject security for disclosure on customer confirmations.[15]

By establishing a standard protocol for calculating the accuracy of security-specific, time-specific Market-Price forecasts published by independent pricing-service providers, FINRA could provide a compelling incentive to current and future pricing-service providers to publish demonstrably accurate Market-Price forecasts. Moreover, competitive pressures would likely also encourage those providers to continually strive to increase the accuracy of their forecasts and to deliver those forecasts on increasingly competitive terms.

It is anticipated that the cost of accessing Accredited-Benchmark prices would be based upon the number of subject securities, timing of updates (real-time or delayed), frequency of updates (end-of-day or intra-day) and other factors. It is also possible that an Accredited-Benchmark pricing service provider, like DelphX, would provide free public access to Accredited-Benchmark prices for limited-use, time-delayed queries.

TRACE-Enabled Validation. We believe FINRA's Transaction Reporting and Compliance Engine ("TRACE") provides a valuable source of timely post-trade pricing information that could be employed to measure and validate the forecasting accuracy of continuous pre-trade Market-Price forecasts published by pricing-service providers. By comparing a given provider's Market-Price forecasts for a subject security current at the time of each transaction in that security, as reported to TRACE, the accuracy of that provider's pre-trade Market-Price forecasts can be definitively determined on a security-specific and aggregate basis for use in the benchmark-accreditation process.

Thus, each time a transaction involving a subject security is reported to TRACE, the degree to which the forecasted Market-Price published at the time the transaction was executed deviated from the transaction's Trade-Price can be definitively measured, recorded and transparently reported to validate the accuracy of the Market-Price forecasts.

Therefore, to provide greater price transparency and facilitate more definitive compliance, we recommend that, in addition to the Proposal's same-day transaction price, broker-dealers alternatively be permitted to disclose on confirmations the current Market-Price forecast of an Accredited-Benchmark for the subject security at the time of the transaction with or for the investor. Investors and all other market participants and regulators would thus gain an informed and transparent basis upon which to assess the current pre-trade pricing levels of most outstanding fixed income issues.

[15] As we discuss below, the Accredited-Benchmark pricing used in customer confirmations would also be useful for best execution and other price-related compliance purposes.

Minimum Accuracy Standard.

It is suggested that to qualify as an Accredited-Benchmark, FINRA would require a fixed income securities pricing-service to:

1) Publish prices for the subject security and updated them continually, or at least as frequently as FINRA specifies, throughout each trading day;

2) Continually meet the acceptable Accuracy-Score levels specified by FINRA (e.g., at least 80.0% of published Market-Price forecasts must possess Accuracy Scores of 98.0% or higher); and

3) Continually report the benchmark's current Accuracy-Score, and transparently publish all information required to independently audit the accuracy of its current and prior Accuracy-Scores and its Market-Price forecasts current at each time the issue has been traded.

One approach for determining the accuracy of prior Market-Price forecasts of a subject benchmark is to compare its Market-Price forecast at the time each trade of the security occurred in the past (using the "Execution" date/time of the trade reported to the TRACE system as the trade-time determinant), as DelphX currently does for calculating the Accuracy-Scores of its MAV≡n® (Market-Adjusted Value per congruent nexus) Market-Pricing forecasts. Specifically, the current Accuracy-Score of the Market-Price forecasts a subject MAV≡n is determined by:

1) Calculating the Absolute Deviation (without regard for the direction of each deviation to avoid distortions due to "netting" of groups of deviations) of each Market-Price forecast from the actual Trade-Price at which the applicable transaction involving the security occurred;

2) Adding the Absolute Deviations of a specified number (e.g., 5) of the most recent transactions involving the subject security;

3) Adding the Trade-Prices of the transactions described above;

4) Dividing the Total Sum of the Absolute Deviations by the Total Sum of the Trade-Prices, to determine the Absolute Deviation-Quotient of the Market-Price forecasts in the analyzed transactions; and

5) Subtracting that Absolute Deviation-Quotient from 100% to determine the Accuracy- Quotient (Score) of the Market-Price forecasts of the subject benchmark.

For example, the Accuracy-Score of the continually-updating benchmark pricing of security A would be calculated as follows:

Calculating Accuracy-Score of Market-Price Forecasts for Security A

Transaction Sequence	Forecasted Market-Price	Actual Trade-Price	Absolute Deviation
Most Recent	112.045	112.392	0.347
2nd Most	109.255	109.641	0.386
3rd Most	110.340	110.950	0.610
4th Most	110.654	109.894	0.760
5th Most	110.873	111.055	0.182
		553.932	2.285

Absolute Deviation Quotient = 0.413% (2.285 ÷ 553.932 = 0.413%)

Accuracy-Score = 99.587% [16] (100% - 0.413% = 99.587%)

Employing Accredited-Benchmarks. We believe that permitting broker-dealers to display an Accredited-Benchmark price on a trade confirmation would be an excellent example of "principles-based regulation" - rather than specifying a solitary method to provide pricing information to achieve its regulatory objective, the rule would allow firms to decide which acceptable method best fits their business model and customer base. Under this approach, a firm would be required to have written policies and procedures reasonably designed to identify an Accredited-Benchmark, provide contemporaneous Accredited-Benchmark pricing information to customers, and periodically review the performance of the Accredited-Benchmark to verify that it continues to satisfy the required criteria and provides meaningful information to its customers.

Accordingly, we recommend that FINRA amend Rule 2232 to permit broker-dealers to disclose as a pricing reference on customer confirmations the Accredited-Benchmark price published for the subject security at the time of the transaction. By including Accredited-Benchmark prices as pricing references on customer confirmations, member firms could thus provide "meaningful and useful" information to investors.

Recognition by FINRA of Accredited-Benchmarks may also tend to increase the frequency with which currently-illiquid issues trade as, by informing investors of the likely current Market-Price of each of a broad range of securities they may have interest in buying or selling, those investors may be more inclined to trade attractively-priced securities with greater confidence and frequency.

[16] More than 94.0% of MAV≡n forecasts published by DelphX currently possess Accuracy-Scores higher than 98.0%.

Best Execution and Fair Prices. SEC Commissioner Gallagher has stated: "Notwithstanding these recent initiatives in post-trade price transparency [17] retail investors continue to face significant market headwinds. They simply cannot be sure that they receive best execution and a fair price." [18] There is a growing consensus that "meaningful pre-trade pricing information" is key to addressing concerns about best execution and markup and markdown disclosure in the fixed income markets.[19]

As described below, there is a close association between the objectives of the Proposal and a FINRA member's obligations to seek "best execution" in executing customer orders, and to charge reasonable markups and markdowns on customer trades. Providing investors with Accredited-Benchmark Market-Pricing could enhance best execution and markup/markdown information and compliance.[20]

Best execution. FINRA Rule 5310 requires that a member "use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions," and indicates that an essential element in assessing the "character of the market for the security" is price.[21] In the fixed income markets, where many if not most securities trade infrequently, determining whether a price offered in the market is reasonable can be difficult and time-consuming. However, a price generated by an Accredited-Benchmark could greatly assist the broker-dealer in assessing whether an offered price is fair. That, in turn, can be incorporated into the other prevailing market factors in satisfying the broker-dealer's best execution obligation. In addition, if the Accredited-Benchmark price were included on the customer's confirmation, the customer would have highly relevant, accurate and reliable information to use in evaluating the broker-dealer's satisfaction of its best execution responsibilities.

Markup policy. FINRA Rule 2121, among other things, requires that a member trade as principal with a customer at "a price which is fair, taking into consideration all relevant circumstances …." Supplementary Material .01 discusses FINRA's markup policy, and provides in relevant part: "It shall be deemed a violation of … Rule 2121 for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security…." [22] Moreover, "[t]he mark-up over the prevailing market price is the significant spread from the point of view of fairness of dealings with customers in principal transactions." [23] Supplementary Material .02 provides guidance for determining the "prevailing market price" in connection with transactions in debt securities (except municipal securities).[24] The Supplementary Material guidance recognizes that contemporaneous transactions in a particular debt security may not be available, and sets forth a

[17] Referring to FINRA's Transaction Reporting and Compliance Engine and the Municipal Securities Rulemaking Board's Electronic Municipal Market Access system.
[18] Remarks by Commissioner Gallagher, supra n.2, at 3-4.
[19] *See, e.g.*, Speech by Chair White, supra n.2, at 6; Remarks by Commissioner Piwowar, supra n.2, at 4-5; Remarks by Commissioner Gallagher, supra n.2, at 4.
[20] Remarks by Chairman Ketchum, supra n.2, at 1-2.
[21] FINRA Rule 5310(a)(1)(A).
[22] FINRA Rule 2121.01.
[23] FINRA Rule 2121.01(a)(3).
[24] FINRA Rule 2121.02(b).

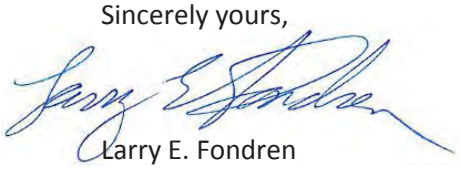
"waterfall" process for determining the prevailing market price.[25] Under certain circumstances, a dealer may take into consideration the prices of transactions in "similar securities" or prices generated by economic models.[26]

We believe that Market-Prices generated by Accredited-Benchmarks will be increasingly superior to virtually all of the options in this waterfall process in determining the current Market-Price of a debt security at any point in time. Also, it incorporates aspects of Supplementary Material .02, such as contemporaneous transaction information and reference to similar securities, and produces empirically accurate, real-time, fair value prices. This could be used by a broker-dealer in evaluating one or more dealer prices, or in determining the prevailing market price for a sale out of the broker-dealer's inventory. If disclosed on the confirmation, the customer would have useful and meaningful information to assess the remuneration retained by the broker-dealer on a trade.

As stated above, we believe that all customers,[27] retail and institutional, would benefit from the timely and historically-accurate Market-Price information provided by Accredited-Benchmarks.[28]

Conclusion. DelphX applauds FINRA for its initiative and is grateful for the opportunity to present an alternative means of increasing pre-trade price transparency and enhancing achievement of the Proposal's objective. We would be pleased to meet with FINRA Staff to provide additional information or answer questions regarding the proposed Accredited-Benchmark utility. Please contact me at (610) 640-7546 (lef@delphx.com).

Sincerely yours,



Larry E. Fondren
President and CEO

cc: Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board
Larry E. Bergmann, Murphy & McGonigle P.C.

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[25] Contemporaneous transactions in the same security by the dealer are presumptively considered to establish the prevailing market price. FINRA Rule 2121.02(b)(1). We note that, while a contemporaneous transaction is a strong indicium of the current market price for a security, the transaction price will reflect the facts and circumstances pertaining to the individual firm, and the price may be superior or inferior to prices that another firm could obtain.

[26] FINRA Rule 2121.02(b)(6), (7), (c).

[27] FINRA Rule 2121.02(b)(9) defines "customer" to exclude certain transactions with institutional customers.

[28] *See* Hendrik Bessembinder, William Maxwell, and Kumar Venkataraman, "Market transparency, liquidity externalities, and institutional trading costs in corporate bonds," Initial Draft: November 2004, Current Draft: October 2005, J. Fin. Econ., forthcoming, at Abstract, 2, 35-37 (study of the "effect of transaction reporting on trade execution costs … using a sample of institutional trades in corporate bonds, before and after the initiation of public transaction reporting through the TRACE system. … The results reported here are important because they verify that market design, and in particular decisions as to whether to make the market transparent to the public, have first-order effects on the costs that customers pay to complete trades. Further, since the sample employed here consists of institutional trades, these results indicate that public trade reporting is important not only to relatively unsophisticated small traders, but also to professional investors who make multi-million dollar transactions")

Submitted electronically to pubcom@finra.org

January 20, 2015

Marcia E. Asquith
Corporate Secretary
FINRA
1735 K St., NW
Washington, D.C. 20006

Re: **FINRA Regulatory Notice 14-52, Request for Comment on Draft FINRA Rule 2232 Amendments, on Same-Day Pricing Information for Retail Fixed Income Transactions**

Dear Ms. Asquith:

The Financial Services Roundtable[1] ("FSR") appreciates the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA's") proposed amendments to FINRA Rule 2232 ("Proposed Amendments"), as set forth in Regulatory Notice 14-52 ("Regulatory Notice"), which would require disclosure on retail customer confirmations of pricing information for same-day transactions in corporate and agency debt securities ("fixed income securities"). The confirmation disclosure requirement would apply whenever a broker-dealer executes transactions in fixed income securities as principal and also effects one or more transactions with a customer in the same security on the same day, provided that the transactions are of a "qualifying size."[2]

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[1] *As advocates for a strong financial future*™, the Financial Services Roundtable represents the largest integrated financial services companies providing banking, insurance, payment, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for $ 92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs. Learn more at FSRoundtable.org.

[2] *See* FINRA Regulatory Notice 14-52, Pricing Disclosure in the Fixed Income Markets, at 3 [hereinafter "Regulatory Notice 14-52"].

The stated purpose of the Proposed Amendments is to increase transparency by providing customers with "meaningful and useful information" about the price differential between what a broker-dealer pays for a security and what it charges the customer for that same security.[3] Specifically, it responds to concerns raised in 2012 by the Securities and Exchange Commission ("SEC") regarding firms' mark-ups and mark-downs on securities.[4] We note that the Municipal Securities Rulemaking Board ("MSRB") is proposing similar amendments to its Rule G-15,[5] and that FINRA and the MSRB are coordinating their respective rulemaking initiatives. Given the nature of the proposed amendments to fixed income confirmation disclosures, FSR believes regulatory coordination is essential, and we commend FINRA and MSRB for these efforts.

FSR's members greatly appreciate efforts to create meaningful transparency in fixed income markets; however, they do not believe that the Proposed Amendments are likely to achieve that objective. Rather, the Proposed Amendments would provide retail customers with information that is at best confusing and at worst misleading. In the process, the Proposed Amendments would impose significant and unwarranted costs on broker-dealers, which would be required to reprogram their confirmation and trading systems, redesign their confirmation forms to squeeze the proposed new disclosure onto trade confirmation forms that lack—as a practical matter—sufficient space to incorporate the proposed disclosure, and undertake costly accounting measures. Many of the costs might be passed along to retail customers, who would face higher fees without any real corresponding benefit. FSR believes the alternatives that it recommends in this letter would better address the goals of the Proposed Amendments. As a result, FSR urges FINRA to abandon the Proposed Amendments.

I. Executive Summary

FSR urges FINRA to abandon the Proposed Amendments for the following reasons:

- Implementation of the Proposed Amendments would not provide retail customers with meaningful and useful information about transaction costs for fixed income securities.
- The Proposed Amendments would impose an unworkable burden on firms to sort through thousands of transactions in real-time to capture, analyze, and report information that, in many cases, would provide retail customers with an inaccurate picture concerning execution costs for fixed income securities.
- There is a significant risk that the proposed disclosure would mislead retail customers about their broker-dealers' mark-ups or mark-downs on their specific fixed income securities trades, because the proposed disclosure would not reflect a complete and accurate picture of all of the factors (including market events) that go into the price paid or received by the retail customer.
- FSR urges the SEC, FINRA, and MSRB to work with the industry and consumer advocates to develop effective educational tools for retail customers that would be

[3] *Id.* at 8.

[4] *Id*. at 3.

[5] *See* MSRB Regulatory Notice 2014-20, Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations.

designed to increase the retail customers' understanding of the way that fixed income securities transactions are effected.

- Reprogramming customer confirmation forms to implement the disclosures required by the Proposed Amendments would entail substantial costs for broker-dealers that may ultimately be passed along to retail customers, thereby increasing retail customers' fees without any corresponding increase in meaningful disclosure to retail customers.
- The Proposed Amendments are overly inclusive and would apply regardless of whether the firm makes or loses money on transactions it executes as principal and even if the principal and retail customer transactions are executed at exactly the same price.
- Although FSR believes FINRA should abandon its Proposed Amendments, if FINRA and the MSRB proceed to implement these or similar initiatives, FSR urges FINRA and the MSRB to coordinate their efforts to ensure the uniformity and consistency of the rules (and their interpretative guidance) in order to minimize disruption.

II. Introduction

FSR's members have a number of concerns relating to the feasibility of capturing the information that would be required to be disclosed under the Proposed Amendments, the usefulness of such information to customers, the overinclusiveness of the Proposed Amendments, and the costs that would be imposed on firms without any corresponding benefits for retail customers.

i. Difficulty capturing the information. It is not uncommon for firms to engage in multiple principal transactions and multiple customer transactions in the same fixed income security on the same day. The Proposed Amendments themselves do not provide any guidance or standardization that would take into account these realities. To fill that void, the Regulatory Notice proposes a complicated patchwork of weighted averages (Example 7); last in, first out accounting ("LIFO") (Example 9); and temporal proximity (Example 10). Capturing this information in real time is impractical and overly burdensome. It would also make it difficult, if not impossible, for broker-dealers to meet their confirmation delivery requirements pursuant to rule 10b-10 under the Securities Exchange Act of 1934, as amended ("Exchange Act").[6]

ii. Confusion. Because of the difficulty in capturing the relevant information, there is a high likelihood that the reference prices that would be disclosed would be inaccurate or misleading. Even setting aside the difficulty of capturing the appropriate reference prices, there is also a significant risk that retail customers would conflate price differentials with mark-ups and mark-downs. For instance, if the principal transaction occurs at the beginning of the trading day and the

[6] Under rule 10b-10, broker-dealers must provide written confirmations at or before completion of [a covered] transaction." *See* rule 10b-10(a) under the Exchange Act.

customer transaction occurs at the end of the day, any number of unrelated market events could be responsible for the price differential. However, the Proposed Amendments do not provide retail customers with any basis for evaluating that possibility. Finally, the Proposed Amendments would require the disclosure of the reference pricing information too late in time for it to be useful and would not provide any basis for retail customers to evaluate or contextualize the information.

iii. Cost. As FINRA is aware, reprogramming customer confirmation systems and redesigning the confirmations themselves is a time-consuming and expensive process. This large financial burden is not offset by any meaningful benefit to retail customers in light of the likelihood of retail customer confusion that would result from the somewhat *ad hoc* disclosure requirements.

iv. Overinclusiveness. The Proposed Amendments would apply regardless of whether the firm makes or loses money on retail customer transactions it executes as principal; they would even apply if the principal and retail customer transactions were executed at exactly the same price. Moreover, they would apply whether the principal and customer transactions are seconds or hours apart and without regard to whether they are "riskless." Such overbreadth imposes unnecessary costs.

v. Uniformity. If FINRA and the MSRB ultimately adopt the respective proposals, we urge FINRA and MSRB to ensure the uniformity and consistency of the rules (and their interpretative guidance) in order to minimize disruption.

II. Difficulty Capturing the Information

The Proposed Amendments would impose an unworkable burden on firms to sort through thousands of transactions in real time to capture, analyze and report information that, in many cases, would provide retail customers with an inaccurate picture concerning execution costs for fixed income securities. The premise of the Proposed Amendments is that there should be a way for retail customers to determine the difference between what they paid for fixed income securities and what their broker-dealer paid for those same securities.

The Proposed Amendments might make sense in a market where the standard practice worked along the following lines: Firm buys X ABC bonds from a dealer and immediately sells X ABC bonds to a customer; Firm then buys Y DCE bonds from a dealer and immediately sells Y DCE bonds to a customer; and so on. However, the realities of the markets are far more complicated. Firms do not build and sell positions in fixed income securities on a paired transaction basis. There is simply no meaningful way for a firm to match in an efficient and price-effective manner the securities sold to customers with particular securities that it has in its inventory or to match securities purchased from customers with securities that it sells in principal transactions.

The Proposed Amendments are silent about the accounting methods that firms should use in order to ensure compliance. Although the Regulatory Notice provides some guidance, it relies

on a patchwork of weighted averages, LIFO accounting, and other approximations.[7] These methods, apart from being confusing and costly to implement, only begin to capture the potential permutations that can exist in a market involving multiple customers and multiple transactions. For example, FINRA does not address the scenario where a broker-dealer purchases bonds from multiple dealers at the same time at different prices, and sells bonds to multiple customers at the same price at the same time. While FINRA members could perhaps extrapolate from the examples provided in FINRA's scenarios a methodology that could be used to derive the reference price to include on a retail customer's confirmation, the information provided would be somewhat of an arbitrary estimate and could mislead investors as to how their broker-dealers actually trade and derive the price to their customers.

Additionally, capturing the information and incorporating it into the confirmation process would make it difficult for broker-dealers to deliver confirmations in a timely manner as required by rule 10b-10. For example, broker-dealers will need processes for identifying the relevant principal transaction or transactions for each retail fixed income trade in accordance with FINRA's methodology, tagging each principal trade to prevent duplicative matches, calculating the price differential, and submitting the data to their confirmation systems (which in many cases are third-party service providers) for inclusion on each retail customer's written trade confirmation. FSR believes that this process will take hundreds of hours and be impossible to complete in order to deliver confirmations to retail customers prior to trade settlement. Even if FINRA continues to believe that reference pricing information should be available to retail customers, FSR submits that requiring this disclosure on trade confirmations is not the appropriate vehicle.[8]

III. Confusion

The objectives of the Proposed Amendments are only served if investors receive useful information. However, the Proposed Amendments, taken together with the accounting methods suggested in the Regulatory Notice, are not reasonably calculated to achieve that goal.

Indeed, there is a significant risk that the information provided to retail customers would mislead them about their broker-dealers' mark-ups or mark-downs on their specific transactions because it would not—and could not in a timely and cost-effective way—provide a complete and accurate picture of all of the factors, including market events, that go into the price paid or received by a retail customer.

As the Regulatory Notice helpfully observes, other factors, including market events, might be responsible for price differentials.[9] Nonetheless, the Regulatory Notice exclusively

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7 *See* Regulatory Notice 14-52 at 4-7.

8 Some possible alternatives are discussed in Part III of this letter.

9 *See* Regulatory Notice 14-52 at 9. The Regulatory Notice says that this concern is minimized because principal and customer trades tend to take place in close proximity to one another. However, even then, a price differential is distinct from a mark-up or mark-down. Moreover, the Proposed Amendments are not limited to transactions that happen close together in time.

characterizes the Proposed Amendments as disclosure regarding mark-ups and mark-downs,[10] which could mislead retail customers into thinking that a particular broker-dealer's mark-up or mark-down is the primary factor in determining a customer's transaction price for a specific fixed income security. For instance, mark-ups and mark-downs will be shown in a vacuum without reference to whether it took the broker-dealer five seconds or five hours to execute the trade. Nor will the Proposed Amendments facilitate accurate comparisons of transaction costs for fixed income securities across firms.

A more useful alternative would be for the SEC, FINRA, MSRB, the industry, and consumer advocates to develop effective educational tools for retail customers that would be designed to increase retail customers' understanding of the way that fixed income securities transactions are effected. This could include efforts to increase retail customers' awareness of tools that already exist to determine much of the information that would be disclosed under the Proposed Amendments.

For instance, the Regulatory Notice observes that under the *status quo*, "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."[11] Indeed, the promise of such publicly-available information was the very reason the SEC decided not to move forward with proposals to increase confirmation disclosure requirements for municipal and other fixed income securities the last time it considered the issue, which was in 1994.[12] Since then, TRACE (along with EMMA for municipal securities) has made dramatic strides in increasing transparency. To the extent that FINRA is concerned that not enough retail customers are aware of these resources, this can be solved through increased education. To the extent that the concern is that more information should be available online, that can be corrected as well without requiring broker-dealers to undertake the burdensome process of updating confirmation disclosures in the way that would be required under the Proposed Amendments.

Broker-dealers could supplement these efforts by providing a toll-free telephone number that their retail customers can use to obtain information about how their broker-dealer handles fixed income securities trades generally, including the mark-up or mark-down charged on any particular transaction. Alternatively, if FINRA believes that it is necessary for additional information to appear on confirmations, it could require firms to disclose the maximum mark-up/mark-down percentage that the firm permits and direct customers to the toll-free number if they have any additional questions.

IV. Cost

FSR estimates that the cost of implementing the Proposed Amendments would be significant. The most significant cost would be reprogramming confirmation forms. As FINRA

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10 *Id.* at 3.

11 *Id.* at 8.

12 *See* Confirmation of Transactions, Securities Exchange Act Rel. No. 34962, 1994 SEC LEXIS 3503, at *4-5 (Nov. 10, 1994) (basing decision to defer consideration of proposals based on MSRB's commitment to develop "significant new ways of making pricing information more widely available to investors").

is aware, this is a time-consuming and expensive process. For instance, as part of a 2010 proposal to change mutual fund disclosures, the SEC estimated that the changes to the confirmation forms alone would take in excess of a million hours and would cost upwards of $250 million.[13] These are substantial costs that may ultimately be passed along to retail customers, thereby increasing their fees without providing meaningful disclosure. The alternatives proposed here would be far less costly, but would still achieve the goal of making more information about fixed income securities available to retail investors.

V. Overinclusiveness

The Proposed Amendments are overly inclusive in a number of ways. For instance, they would apply regardless of whether the firm makes or loses money on transactions it executes as principal; they would even apply if the principal and retail customer transactions are executed at exactly the same price. This approach subjects firms to the burdens of the Proposed Amendments without any analysis of whether the information disclosed is likely to be of any utility to the customer.

Significantly, the SEC's 2012 report only recommended disclosure for "riskless principal" trades.[14] However, the Proposed Amendments go beyond that recommendation and encompass all trades that occur within the same day. The Regulatory Notice suggests that limiting the proposal to riskless principal trades might be unworkable.[15] The proposed approach, however, overlooks the fact that broker-dealers are able to determine which trades are riskless for purposes of complying with rule 10b-10(a)(2)(ii)(A) under the Exchange Act.

VI. Uniformity

If FINRA and the MSRB ultimately move forward with their respective proposals, FSR urges FINRA and the MSRB to ensure the uniformity and consistency of the rules (and their interpretative guidance) in order to minimize disruption and confusion among retail customers who may receive customer confirmations for corporate and municipal securities, each of which would have different disclosure requirements.

For instance, both regulators should use the same terminology to refer to third-party transactions. Currently, the MSRB uses the term "reference transactions." It would be helpful for FINRA to adopt the same term, or for both regulators to agree on some alternative that would be the same for both of them.

More importantly, the regulators should work together to ensure that the standards are the same for when disclosure is required, and that the methodologies and accounting methods are standard and consistent. A failure to ensure uniformity would impose even greater costs on firms

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13 *See* Mutual Fund Distribution Fees; Confirmations, 75 Fed. Reg. 47064, 47126 (Aug. 4, 2010).

14 *See* Regulatory Notice 14-52 at 3.

15 *See id.* at 10 ("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.").

by requiring them to reprogram their confirmations according to two separate protocols.

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FSR appreciates the opportunity to comment on FINRA's Proposed Amendments. If it would be helpful to discuss FSR's specific comments or general views on this issue, please contact Richard Foster at Richard.Foster@FSRoundtable.org or Felicia Smith at Felicia.Smith@FSRoundtable.org.

Sincerely yours,

Vice President and Senior Counsel for
Regulatory and Legal Affairs
Financial Services Roundtable

With a copy to:

Financial Industry Regulatory Authority
Robert L.D. Colby, Chief Legal Officer
Patrick Geraghty, Vice President, Market Regulation
Cynthia Friedlander, Director, Fixed Income Regulation, Regulatory Operations
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Consumer Federation of America

January 20, 2015

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, Virginia 22314

Re: FINRA Regulatory Notice 14-52; MSRB Regulatory Notice 2014-20
Pricing Disclosure in the Fixed Income Markets

Dear Ms. Asquith and Mr. Smith:

I am writing on behalf of the Consumer Federation of America (CFA)[1] to express our strong support for FINRA's and MSRB's proposed rules to require heightened confirmation disclosure of pricing information in fixed income securities transactions. By requiring firms to disclose on their 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, the proposed rules will provide retail investors with critical cost information. This information will put them in a better position to assess whether they are paying fair prices and whether their dealers are fulfilling their best execution duties. As a result, this information will allow retail investors to make more informed investment decisions. These rules will also foster increased price competition in fixed income markets, which will ultimately lower investors' transaction costs.

The bond market plays a critical role in our nation's economy. The corporate bond market allows companies to finance their medium- and long-term capital investment and growth, and the municipal bond market allows cities, counties, and states to build schools, bridges, roads, sewer systems, hospitals, and other vital infrastructure. The bond market's significance is matched by its size. As of the fourth quarter of 2013, there was approximately $7.46 trillion

[1] CFA is a non-profit association of nearly 300 national, state, and local pro-consumer organizations. It was formed in 1968 to represent the consumer interest through research, advocacy and education.

outstanding in corporate debt and $3.67 trillion outstanding in municipal debt, according to SIFMA.[2]

Retail investors provide corporations and municipalities with a significant amount of that capital by buying the bonds that corporations and municipalities offer. For example, as of March 2013, retail investors held directly or indirectly approximately 28 percent of the total outstanding principal value of the corporate bond market and approximately 75 percent of the total outstanding principal value of the municipal bond market.[3] Retail investors' participation in the municipal bond market is especially striking, as they held approximately 50 percent of outstanding municipal bonds directly.[4]

While retail investors are important participants in fixed income markets, they are disadvantaged in concrete ways when they transact in these markets. First, retail investors pay substantially more to trade in corporate and municipal bonds than they pay to trade in equities. Second, they pay substantially more to trade in corporate and municipal bond transactions than sophisticated traders. Theoretical and empirical evidence suggests that these price discrepancies are largely due to the fact that fixed income markets are opaque, and retail investors are not receiving information that would allow them to make better-informed decisions and pay lower transaction costs. In short, without essential price information, financial intermediaries are able to extract rents from their less well-informed retail customers by charging them higher transaction costs.

SEC Commissioner Michael Piwowar arguably has done more than anyone in recent years to highlight the ways in which retail investors have been harmed in fixed income markets. In 2007, Piwowar astutely observed: "Bond markets have been notoriously opaque….The lack of transparency in the bond markets has allowed market professionals – including sophisticated investors, brokers and dealers – to obtain vast sums of money from unsophisticated investors *and* taxpayers."[5]

Retail Investors' Trading Costs

Research on retail investors' trading costs for municipal and corporate bonds conducted by Piwowar, Lawrence Harris and Amy Edwards, has found that retail investors pay substantially more to trade municipal and corporate bonds than they pay to trade similar-size common stocks. In June 2006, Piwowar and Harris published a paper that examined municipal bond transactions through October 2000, and found, for example, that the average effective spread of a $20,000 municipal bond trade was almost 2 percent (1.98 percent) of the price. To put that cost in perspective, they pointed out that it is the equivalent of almost four months of the total annual return for a bond with a 6 percent yield to maturity. However, in today's low interest rate environment, that cost is even more pronounced; it is the equivalent of almost eight months of the total annual return for a bond with a 3 percent yield to maturity. In comparison to a

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[2] SIFMA Statistics, US Bond Market Issuance and Outstanding, http://bit.ly/1CL2CDz.
[3] *See* Luis Aguilar, **"**Keeping a Retail Investor Focus in Overseeing the Fixed Income Market**,"** Remarks at the Roundtable on Fixed Income Markets, Washington, D.C. April 16, 2013, http://1.usa.gov/1wnUjZr. (citing Federal Reserve Flow of Funds data).
[4] *Id*.
[5] Michael S. Piwowar, Corporate and Municipal Bonds, Securities Litigation and Consulting Group, Inc., 2007, http://bit.ly/1CwCN9V.

similar-sized equity trade of 500 shares of a $40 stock ($20,000), Piwowar and Harris found that this would be equivalent to an effective spread of 80 cents per share. Even the most illiquid stocks rarely have spreads that wide.[6]

A 2007 paper by Piwowar, Harris, and Edwards examined corporate bond transactions in 2003 and found that the average effective spread of a $20,000 corporate bond trade was 1.24 percent of the price, making it the equivalent of over two months of the total annual return for a bond with a 6 percent yield to maturity. Putting that cost in perspective relative to today's interest rates, it is equivalent to almost 5 months of the total annual return for a bond with a 3 percent yield to maturity. In comparison to a similar-sized equity trade, Piwowar, Harris, and Edwards found that this cost would be equivalent to an effective spread of 52 cents per share.[7]

In both studies, researchers found that trading costs decrease dramatically with trade size, meaning that retail investors generally pay substantially more than institutional investors to trade a bond. This is in stark contrast to equity markets, in which retail investors generally pay lower transaction costs than institutional investors to buy and sell stocks due to the lower price impact of trading smaller amounts. These results are consistent with the theory that dealers charge their less sophisticated, less well-informed customers much more than their more sophisticated, more well-informed customers.

Research by Erik Sirri on trading costs in the municipal securities market found a similar price impact based on trade size.[8] Sirri found that the average total price differential of moving municipal securities from one non-dealer investor to another dropped demonstrably as trade size increased. For example, Sirri found that trade sizes of up to $5,000 had an average total customer-to-customer differential of 246 bps (2.46 percent), whereas trade sizes of $25,000, which was the median trade size, had an average total customer-to-customer differential of 198 bps (1.98 percent). Larger trade sizes experienced even greater reductions in average total customer-to-customer differentials, with $100,000 trades resulting in a 28.7 percent lower average total customer-to-customer differential compared to $25,000 trades, and $1 million trades resulting in a 64.9 percent lower average total customer-to-customer differential compared to $100,000 trades.

In addition, Sirri found that 25 percent of all customer-to-customer transactions resulted in a total customer-to-customer differential of more than 288 bps (2.88 percent), and 10 percent resulted in a total customer-to-customer differential of more than 365 bps (3.65 percent). While these transaction chains did not factor in the number of dealers involved, the trade size, or the total length of time necessary to execute, these numbers suggest that it may not be out of the ordinary for many retail investors to pay extremely high transaction costs for their municipal bond transactions.

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[6] Lawrence Harris and Michael Piwowar, Secondary Trading Costs in the Municipal Bond Market, *Journal of Finance* 61, 1361-1397 (2006), http://bit.ly/1J3owpC.

[7] Amy Edwards, Lawrence Harris, and Michael Piwowar, "Corporate Bond Market Transaction Costs and Transparency," *Journal of Finance* 62, 1421-51 (2007), http://bit.ly/1Bb6y0y.

[8] Erik R Sirri, Report on Secondary Market Trading in the Municipal Securities Market, July 2014, http://bit.ly/1xuslwC.

Sirri also found that paired-trade differentials are noticeably higher when trades involve a customer, as opposed to another dealer. For example, the average customer-to-customer differential was 178 bps (1.78 percent), whereas the average differential of moving municipal securities from another dealer to a customer who bought municipal securities was 146 bps (1.46 percent), and the average differential of moving municipal securities from a customer who sold municipal securities to another dealer was 67 bps (0.67 percent). As expected, the average differential of moving securities from one dealer to another dealer was the lowest, at 50 bps (0.5 percent). This evidence supports the conclusion that dealers may be taking advantage of less-informed customers by charging them higher transaction costs, while charging each other minimal costs to trade securities.

Bond Market Opacity

For all the recent attention U.S. equity market structure has received recently, there is much greater price transparency in our equity markets than there is in our fixed income markets. For example, retail stock investors can see a continuous stream of publicly available information about the prices at which other market participants may be willing to buy or sell stocks. No publicly available pre-trade price information exists in the bond market.

In addition, firms are required to provide on their customer's confirmation the transaction costs the customer paid for all stock transactions, regardless of whether the firms executed the transaction in an agency or principal capacity. In bond transactions, firms are only required to provide on their customer's confirmation the customer's transaction costs if the firm executed the transaction in an agency capacity. Thus, if an intermediary arranges a trade for a customer on an agency basis, the intermediary must disclose on the customer's trade confirmation the transaction costs he or she paid, reflected as a commission. However, if an intermediary arranges a trade for a customer on a principal basis, the intermediary has no duty to disclose on the customer's trade confirmation the transaction costs he or she paid, reflected as a markup or markdown. This is essentially a regulatory loophole that allows bond intermediaries to treat functionally equivalent transactions differently for disclosure purposes, based on how they choose to characterize their transactions.

Given this regulatory inconsistency, which allows firms to choose whether their clients receive confirmation disclosure of the costs they are paying, it is hardly surprising that firms execute virtually all customer transactions in a principal capacity. This allows firms to effectively withhold information from their clients that their clients would find useful. As a result, firms are able to charge more than they otherwise would if they provided that cost information to their clients. Ironically, because customers do not see any transaction costs on their confirmations, they may mistakenly believe that they aren't paying any trading costs on their bond transactions. In reality, they are likely paying some of the highest trading costs in the market.

We recognize that there have been notable efforts to increase post-trade transparency in the bond market in recent years. In July 2002, Transaction Reporting and Compliance Engine (TRACE) began requiring bond dealers to report transaction data in U.S. corporate bonds in near real-time to what was then the National Association of Security Dealers (now FINRA), which made that transaction data available to the public for free. Similarly, in January 2005, the MSRB

began disseminating U.S. municipal bond pricing data to the public in real-time and for free. Market information was first posted on the Bond Market Association's investor education website, but was relocated in March 2008 to MSRB's Electronic Municipal Market Access (EMMA) website. There is evidence that overall transaction costs have decreased, both for corporate and municipal bond transactions, since transaction data has been made available.[9]

However, while overall bond trading costs have fallen as a result of increased price transparency, the evidence suggests that those benefits have not been noticeable for all investors. According to Commissioner Piwowar, for example, while institutional and sophisticated investors have seen their bond trading costs fall, retail investors' trading costs remain high. This is likely because institutional and sophisticated investors know that TRACE and EMMA exist, know how to access the information on those sites, and know how to interpret the transaction information that they find in order to gauge whether they are paying fair prices. Most retail investors, on the other hand, likely do not know the websites exist and, even if they did, are not in a position to use those websites with any reasonable degree of expertise. As a result, they likely are not able to realize the benefits that these websites can offer.

Unrealistic Expectations of Retail Investors

It's not realistic to expect retail investors to use TRACE and EMMA with any reasonable degree of expertise. In order to use TRACE and EMMA, one has to know each website exists and what specifically each website offers. It would likely confuse an investor that he or she has to go to different websites to see different types of recent bond transactions. Even assuming that a retail investor knows that those websites exist, one would have to know the precise information one is looking for; then, one would have to actually find that information. Finally, assuming that a retail investor knows what information to look for and finds it, one would need to be able to understand and make use of that information for one's benefit.

Assuming an investor Googles "FINRA TRACE" and clicks on the first option, the investor would somehow need to know—or find through trial and error—that out of the roughly seventeen options, he or she should click on "corporate bond data." Then the investor would have to click on www.finra.org/marketdata to find information on individual bonds, then enter relevant search terms, followed by agreeing to the user agreement, before coming to the relevant recent trade data. Once an investor finally navigated to the relevant data, he or she would have to make sense of it all. That would require an understanding of what all of the different columns mean (trade quantity, price, yield, coupon, maturity, time of execution, trade data), what the various rows mean in relation to one another, and how the rows and columns relate to the price the investor paid. Expecting an unsophisticated retail investor to navigate through this burdensome maze and then understand all of the data presented so that it is useful is too tall an order.

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[9] Bessembinder, Maxwell, and Venkataraman (2006), Edwards, Harris, and Piwowar (2007), and Goldstein, Hotchkiss, and Sirri (2007) conclude that the increased transparency associated with TRACE transaction reporting was associated with a decline in investors' average trading costs in corporate bonds. *See* Hendrik Bessembinder and William Maxwell, Markets, Transparency and the Corporate Bond Market, Journal of Economic Perspectives, Volume 22, Number 2, Spring 2008. Deng (2013) and Sirri (2014) conclude that the MSRB's Real Time Reporting System and EMMA were associated with a decline in investors' average trading costs in municipal bonds. *See* Gene Deng, Using Emma to Assess Municipal Bond Markups, Securities Litigation Group, 2013.

EMMA is significantly easier to use than TRACE, with video tutorials and visual depictions of recent trade information. However, even EMMA requires a certain amount of sophistication to make use of the data that is presented. Despite EMMA's more user-friendly design, it is unrealistic to expect an unsophisticated retail investor to understand all of the data that is presented, and then to make productive use of that data.

To understand why it is unrealistic to expect retail investors to use TRACE and EMMA productively, one must consider a typical retail investor's financial literacy. Extensive research has documented the disturbingly low levels of financial literacy among American investors. For example, the SEC's August 2012 study regarding financial literacy among investors found that retail investors "do not possess basic knowledge of interest rates, inflation or risk, all of which are essential to making well-informed investment decisions."[10] More specifically, they are essential to making well-informed bond transaction decisions. If retail investors do not possess these basis levels of knowledge, there is little likelihood they will be able to use TRACE and EMMA with any degree of skill or expertise or even that they will know of their existence.

It may be particularly unrealistic to expect fixed income retail investors to use TRACE and EMMA. Fixed income markets are generally tilted to the elderly, and the elderly have been shown to use the internet in lower percentages than the general population. For example, while roughly 80 percent of American adults use the internet, only 54 percent above the age of 65 use the internet.[11] Thus, the retail investors who would most benefit from certain pricing information may not have access to it.

Method of Delivery Matters

The only way to ensure that retail investors are receiving necessary cost information is to provide it directly to them. Research shows that the method that information is delivered matters. Information must be provided in an easily accessible manner, with as few barriers as possible, to have the highest impact and be most effective. Just because the information is available somewhere does not mean that it will be accessed. And, in fact, when CFA surveyed investors for a report on internet disclosures, investors were very skeptical of disclosures being made available but not being provided directly.[12]

Therefore, for bond price disclosures to be the most effective and to fulfill investor preferences, we strongly support directly providing retail investors on their confirmations the costs they are paying, the costs their dealers are paying, and the differentials between those two prices. Directly providing retail investors with this information rather than requiring them to search it out on their own will lower the barriers to access that retail investors currently confront, increasing the likelihood that they see and understand the transaction costs they are paying. With this information presented to them, they will be in a better position to assess whether they are

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[10] Study Regarding Financial Literacy Among Investors, As Required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Staff of the Office of Investor Education and Advocacy of the U.S. Securities and Exchange Commission, at vii-viii, August 2012, http://1.usa.gov/1fMABVZ.

[11] *See* Barbara Roper, Can the Internet Transform Disclosures for the Better?, Consumer Federation of America, January 2014, http://bit.ly/1CwEbJS.

[12] *Id*.

receiving a fair deal and whether their dealers are fulfilling their best execution duties. As a result, this information will allow retail investors to make more informed investment decisions.

With regard to the specific proposal, we believe FINRA and MSRB have done a sensible job in crafting a workable rule that is likely to benefit retail investors significantly. Regarding a few specific points:

- Defining "qualifying size" as a purchase or sale transaction of 100 bonds or less or bonds with a face value of $100,000 or less strikes us as a reasonable attempt to capture those trades that are retail in nature. According to Sirri's research in the municipal securities market, 14.7 percent of all trades were in par amounts over $100,000. Assuming those numbers are similar in the corporate context, it is likely that those trades are being undertaken by more sophisticated, wealthier investors, possibly even small institutions. However, it is still possible for unsophisticated retail investors to be trading more than what is considered a qualifying size under the rule. Moreover, it might be possible for dealers to game the system by conducting transactions that fall just outside the size limits of the rule. Therefore, we urge FINRA and MRSB to continue to monitor the costs of transactions that fall outside the definition. If it appears that certain investors are transacting in larger quantities and par amounts and are being taken advantage of by paying excessively high transaction costs, and FINRA and MSRB believe that they are paying those costs because the definition of qualifying size is too narrow or too rigid, FINRA and MSRB should seek to expand the definition of the rule.
- Limiting the proposal to same trading day appears to be a reasonable constraint on the application of the rule. FINRA has observed that over 60 percent of retail-size customer trades recently had corresponding principal trades on the same trading day. In over 88 percent of these trades, the principal and the customer trades occurred within thirty minutes of each other. Similarly, Sirri found that 57.7 percent of the total number of trade pairs occurred on the same day, and that almost 85 percent of same day pair trades occurred within thirty minutes of each other. If current trading patterns continue, these trades will be captured under the rule. However, it is possible that dealers' trading patterns might change to avoid having to comply with the rule. For example, they could hold positions overnight to avoid being subject to the disclosure requirements of the rule. While we don't think firms are likely to subject themselves to substantial increases in risk merely to avoid complying with the rule, we cannot rule out the possibility that they would view this as a reasonable risk. We therefore urge FINRA and MSRB to continue to monitor trading activities to ensure that the intent of the rule is being fulfilled to the maximum extent possible.
- We strongly support requiring disclosure of pricing information for all trades in the same security on the same day of trading rather than limiting disclosure to riskless principal transactions. We agree that it will allow for a more mechanical approach by firms than a riskless principal approach, which may require firms to conduct a trade-by-trade analysis to determine whether a specific trade was "riskless." This approach will also allow for a

more mechanical regulatory review for compliance by FINRA and MSRB. Toward this end, we are pleased that vague and difficult to apply terms such as "essentially riskless" and "nearly contemporaneous" were not included in the rules' language.

- One clarification in the proposal is absolutely necessary regarding disclosure of the difference between the customer's price and the intermediary's price. We strongly urge FINRA and MSRB to require dealers to disclose the amount of the price differential BOTH as a percentage of the total amount AND as a total dollar amount based on the number of bonds purchased or sold. Ample research shows that retail investors have trouble comparing percentages and total amounts in costs, and that total dollar amounts are far more compelling to investors than percentages.[13] Furthermore, as question 5 in FINRA's proposal demonstrates, even in the simplest of transactions, several steps would be required for an investor to compute the total dollar amount differential. The likelihood of human error is extremely high. And, if retail investors do in fact make computational errors, the utility of this entire proposal will be seriously diluted. Therefore, it is imperative that this information be provided to retail investors in the clearest way possible.

Countering Industry's Arguments

We expect extensive industry opposition to this proposal, given that dealers have a vested interest in maintaining a certain level of opacity in this market so they can continue to extract rents from less-informed customers. This proposal is likely to threaten dealers because fostering increased price awareness and competition will ultimately lower investors' transaction costs, thereby lowering dealers' profits. We would like to address several industry arguments we have already seen:

- "Investors may see the prices and price differentials they are paying, but not understand them in the context in which dealers operate. Those prices don't reflect all the work dealers undertake to arrange customer transactions." That may be true. Dealers are entitled to reasonable compensation for their services, and if certain services, such as locating and arranging transactions in illiquid securities, are more labor intensive, dealers should be paid accordingly. However, that does not mean their customers should not be provided necessary cost information. What it means is dealers should be able to justify the costs that they charge their customers.
- "Investors will be annoyed and confused to see the costs they are paying." The implication of this argument is that investors are not aware of the costs they are paying now, and letting them in on the truth of what they're actually paying will make them upset. Perhaps they should be upset to learn the amount of transaction costs they've been paying. As a result of providing customers cost information directly, it may create an environment in which they are able to be more cost sensitive.
- "More price transparency will harm bond market liquidity." This is the same argument the Bond Market Association, the trade organization for bond dealers, made when

[13] *Id*.

TRACE became operational. While industry claimed that corporate bond trading would be more difficult, several studies found that trading costs decreased, and liquidity and trading activity increased. There is no reason that providing much of the same information through a more effective transmission channel will have any deleterious effect on liquidity.

Conclusion

While we do not believe that disclosure alone can address the many issues that affect retail investors, disclosure is an essential investor protection tool that, if done properly, can increase the likelihood that investors make more informed choices. Even minor improvements to the content and delivery of the disclosures that retail investors receive can influence investors' understanding of information and the choices they make as a result.

Retail investors in fixed income markets currently are paying extremely high transaction costs, and evidence suggests that they are paying those costs because they are not being provided essential cost information. These proposals will put retail investors in a better position to understand the costs they are paying and to assess whether those costs are reasonable. The information that is provided will also foster increased price competition in fixed income markets, which experience suggests will ultimately lower investors' transaction costs. We therefore strongly support FINRA's and MSRB's proposals to enhance fixed income market transparency for retail investors.

Respectfully submitted,

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January 20th, 2015

SENT VIA ELECTRONIC SUBMISSION

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Ronald W. Smith
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RE: FINRA Regulatory Notice 14-52 and MSRB Regulatory Notice 2014-20

Dear Mr. Smith and Ms. Asquith:

Interactive Data appreciates the opportunity to comment on the coordinated rule proposals FINRA 14-52 and MSRB 2014-20, concerning the disclosure of pricing information on retail fixed income transactions published November 17, 2014. We support the overarching goal of increased transparency for fixed income investors and the commitment of the Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB) in this area. The goal of increased transparency should balance the costs to the industry with the utility of the proposed disclosures to investors, while minimizing any deleterious effects to the fixed income markets.

Interactive Data is not a broker/dealer, and therefore is not well positioned to comment on many of the questions posed in the releases, such as those concerning the mechanics of confirmation statement generation. Rather, our comments focus on our observations regarding transaction costs in fixed income markets and the usability of the proposed disclosures to retail investors. We find that while the proposals would generate additional information for retail investors, these investors would continue to lack the necessary context or insight to be able to interpret that

information. As a result, we suggest alternative disclosures and methods of communication with retail investors be explored.

Interactive Data provides independent evaluations to over 5,000 global organizations, including banks, brokers, insurance firms, hedge funds and mutual funds. These evaluations underpin many facets of the fixed income investment lifecycle, ranging from trading, OMS and portfolio analytics platforms (such as our own BondEdge analytics solutions), to performance, risk and compliance systems, as well as portfolio accounting and NAV calculation processes. The foundation of our approach to evaluating 2.7 million instruments lies in the combination of our extensive set of market data (including FINRA's TRACE® and the MSRB Real-time Transaction Reporting System, along with additional pre-trade information sourced from both the sell side and buy side), our rich set of models, and the expert oversight provided by an Evaluated Services team of approximately 200 professionals. More recently, Interactive Data has developed Continuous Fixed Income Evaluations, producing an intraday streaming fixed income evaluation service that can assist with pre-trade price discovery and post-trade performance analysis among other applications.

Interactive Data's immersive evaluations approach makes us a keen observer of fixed income market trends, including shifting patterns in trade size and frequency. To help communicate our perspective based on these market surveillance activities, we have recently undertaken a 2010-2014 update to our previous, external transaction costs white paper from 2010. Both papers are available on the Interactive Data website[1] and will be referenced throughout this letter. Our comments in this letter derive from our role as an independent market observer and our associated understanding of the expertise that is required to assess and translate such transaction cost data.

As noted above, the recent paper "Transaction Costs in the Corporate, Municipal and Agency Bond Markets, 2010-14" updates Interactive Data's prior white paper "Corporate and Municipal Bond Trading Costs During the Financial Crisis" published in 2010. The 2014 paper examines patterns of transaction costs over time, for both paired and unpaired trades, by employing three different measurement approaches. The paper concludes that:

[1] See "Corporate and Municipal Bond Trading Costs During the Financial Crisis" by Ciampi and Zitzewitz, 2010 and "Transaction Costs in the Corporate, Municipal and Agency Bond Markets, 2010-14 by Zitzewitz, 2014. http://go.interactivedata.com/rs/idglobalcrm/images/Corporate-and-Municipal-Bond-Trading-Costs-During-the-Financial-Crisis-Aug-2010.pdf
http://go.interactivedata.com/Transaction-Costs-Jan-2015-Web-WPR.html

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- Transaction costs for the period of 2010-14 were both relatively stable[2] and generally lower than they were during the credit crisis[3].
- Small, intra-period increases in transaction costs were also noted during periods of volatility for particular asset classes, such as in late 2011 for corporate bonds.[4]
- Paired-bond activity, suggesting riskless principal transactions, was also prevalent, although transaction costs for both paired and unpaired dealer-client transactions were similar.[5] However, an examination of the distribution of transaction costs within size bands illustrates clear asymmetry with a larger 90^{th}-50^{th} percentile difference for client buys and a larger 50^{th}-10^{th} percentile difference for client sells.[6]
- Interdealer trades that are paired with client trades reflect transaction costs that are about half of those paid by clients.[7]
- Transaction costs exhibit a direct relationship with length to maturity and an inverse relationship with credit quality.
- Average transaction costs for smaller trades continue to be higher than for larger trades. However, it was noted that transaction costs for very small trades (less than $10,000) are no larger than those in the $10k-50k range.
- The 2014 paper also compares the differences in transaction costs observed when using Continuous Fixed Income Evaluations[8] (updated on a streaming basis throughout the trading day) and finds that by eliminating the 'noise' introduced by overnight bond movements, the measurement error is reduced significantly and the length of the tails decrease. In other words, transaction costs, when measured against a valuation benchmark on an intraday basis, tend to exhibit a tighter distribution[9].

[2] See figures 11 and 12 from the 2014 paper.
[3] Although the methodologies are not exactly the same, these patterns can be generally observed by comparing 2010 with 2008-9 in Tables 3A and 3B of the 2010 paper and comparing 2010 with 2011-14 in Figures 5A and 5B of the 2014 paper
[4] See page 8, and Figures 11 and 12 of the 2014 paper.
[5] See Tables 2A, 2B and 2C as well as Figures 2A, 2B and 2C of the 2014 paper.
[6] See Tables 4A-4D and Figures 4A-4D of the 2014 paper.
[7] See Tables 2A-2C of the 2014 paper.
[8] Interactive Data launched Continuous Fixed Income Evaluations in 2014. For additional information, please refer to http://www.interactivedata.com/Assets/DevIDSite/PDF/InteractiveData_Continuous-Evaluated-Pricing.pdf
[9] This reduction in distribution can be seen by comparing Figures 4A and 4D as well as Tables 4A and 4D from the 2014 paper.

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Taken together, we believe the findings outlined above highlight the compound nature of fixed income transaction cost variability. These costs tend to differ not only according to the size of the trade, but by bond characteristic (distance to maturity, credit quality, recency of issuance, relative liquidity), by market conditions (especially volatility) as well as by trading partner and execution method.

The rule changes detailed in FINRA release 14-52 and MSRB release 2014-20 generally propose that for certain retail-sized trades (mainly $100k or less), additional information concerning same-day offsetting trades be provided to the client as part of the confirmation statement. The underlying rationale is that having this information will enable the retail investor to understand the effective mark-up or mark-down realized by their broker/dealer, allowing the client to discern the reasonableness of the transaction cost and execution price. However, given the complexities of the bond market and the variability of transaction costs described above, it seems unlikely that the average retail investor (who does not trade frequently and is not expert in fixed income markets) will be able to interpret the new mark-up or mark-down information. For example, on a $50,000 transaction, an effective one point mark-up might be a very low transaction cost for the purchase of a 15 year, high-yield corporate, but the same one point mark-up would be relatively expensive for the purchase of a 5 year, high-grade municipal. It is hard to imagine, absent some form of additional market context, that a casual retail investor would have the baseline knowledge necessary to understand this transaction cost data.

We believe alternative approaches should be considered that offer meaningful context and therefore permit the retail investor to better understand the transaction cost and execution price. As proffered in both the MSRB[10] and FINRA[11] releases, we believe that third-party prices can be leveraged to better inform retail investors. In particular, an accepted, intra-day benchmark valuation for a specific security, displayed with an illustration of the likely range of expected variation in trades (factoring in size of transaction), would offer the retail client meaningful information about their trade. With these additional details, the aforementioned investor in a15 year, high-yield corporate bond would be able to observe that their execution was clearly within

[10] See page 15 of MSRB's 2014-20 release - "The MSRB could also require the inclusion of other market information (e.g., prices provided by external pricing services) on the confirmation. The MSRB seeks comments on whether any of these alternatives provide customers with more meaningful and useful information, whether that value of additional information can be quantified, and the degree to which any of these alternatives would be more or less costly to implement."

[11] See page 12 of FINRA's 14-52 release - "Rather than using the price to the firm, would the best available representation of current market price be more useful… If so, given the infrequent trading in many bonds, what would be an acceptable reference price to use to measure the current price?"

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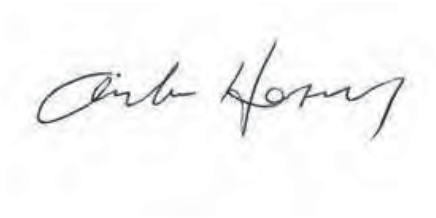
the expected range of prices, while the investor in a 5 year, high-grade municipal bond could see that their execution fell outside of the expected range. Furthermore, it is possible that such an approach – if available as an alternative to the proposed display of offsetting trades - could be less costly for firms to implement, particularly if industry participants were to provide the information via a website link.

Further detail on information that could be made available for retail clients as part of an alternative approach is included as an appendix. These screens are not meant to specifically represent investor-ready information, but are included to help illustrate the possible direction that such an approach could take. The underlying data and delivery mechanisms necessary to deliver such clarifications exist now and could be rolled out to broker/dealers.

Interactive Data appreciates the opportunity to comment on these rule proposals and welcomes further discussion concerning the information provided.

Sincerely,



Andrew Hausman

President, Pricing & Reference Data

Interactive Data

Appendix:

Figure 1

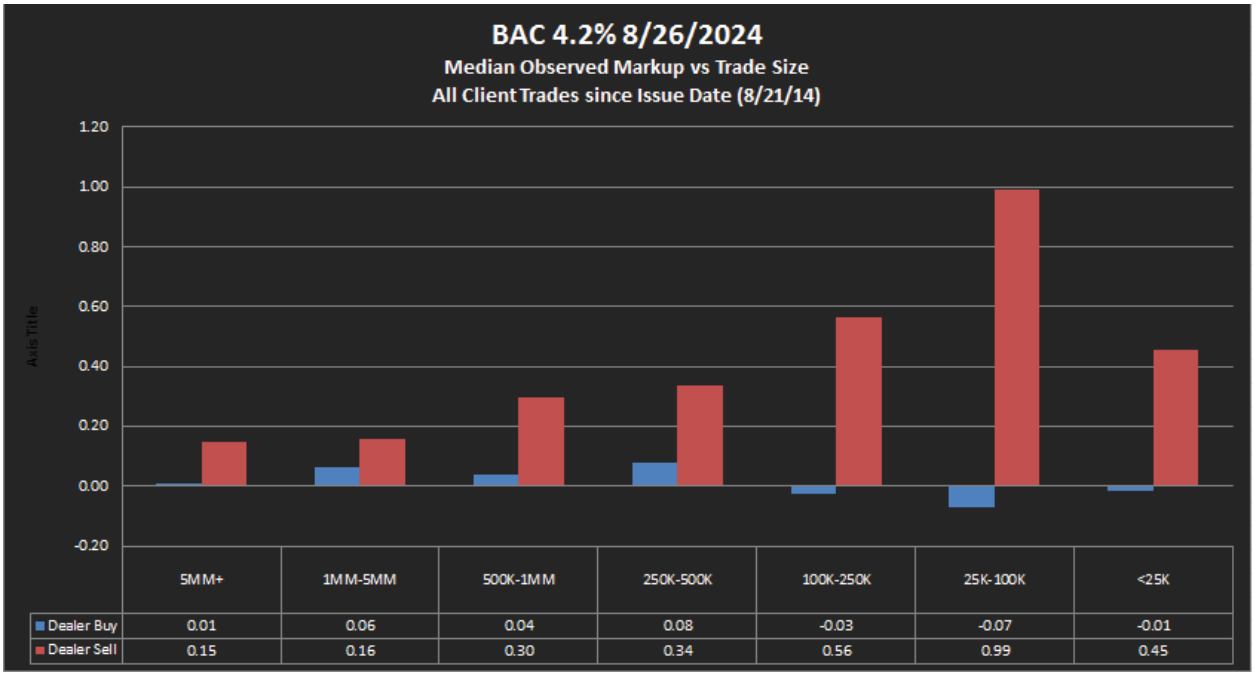


Figure 1 displays an example of observed mark-ups by trade size for Bank of America's 4.2% bond maturing on 8/26/2024. The size of the markup was estimated as the median difference between the transaction price reported to FINRA's TRACE® system and the corresponding bid side of Interactive Data's Continuous Fixed Income Evaluated Price (CEP). The consistently low deviations for dealer buys suggests that, in the absence of an actual transaction, the continuous evaluated bid price provides a representative benchmark for a dealer's acquisition cost and, by extension, the transaction cost incurred by investors when they buy bonds.

We believe retail investors would be more likely to understand the cost of fixed income trades if the reference price presented with each trade captured the collective experience of investors. For this particular bond, half of the buyers making purchases between $25,000 and $100,000 were charged no more than $0.99 above the price at which dealers would be able to buy the bond.

Interactive Data

Figure 2

Figure 2 displays an illustration of Apple's 2.4% bond maturing on 5/3/2023. The blue line display's Interactive Data Continuous Fixed Income Evaluations for this particular security, while the red circles indicate dealer-to-client sells (the circle's area corresponds to the size of trade), the green circles indicate dealer-from-client buys and the yellow circles show intra-dealer trades.

January 2, 2015

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 200006-1506

RE: Comment regarding FINRA Proposed Rule 2232 – Pricing Disclosure in the Fixed Income Markets

I am president, CCO and CEO of Institutional Securities Corporation, an introducing broker-dealer that is considered a "small firm" under the FINRA definition. My firm is an active participant in the fixed income markets, conducting fixed income trades every day. I am writing in opposition to this proposed rule, as I believe that if adopted as currently written, the rule would disproportionately hurt small member firms to the benefit of large broker-dealers. More specifically, as written, the rule would enable large firms to circumvent price disclosure simply by holding bond positions overnight in inventory, while small firms that do not necessarily have the regulatory capital to do so will become competitively disadvantaged against their larger peers as they report prices and see margins continue to deteriorate. The consequence of a further unleveled playing field will lead to further degradation of the small broker-dealer business model, further industry consolidation, and fewer FINRA member firms.

In my experience, while price transparency is certainly an ideal, price is just one component of the value of any particular product, especially in non-quoted markets like fixed income. My firm has brokers that work very hard to research issues and obtain the best prices they can for their clients, inclusive of markups/markdowns. The value they bring in working a bond, on both the buy side and the sell side, often results in better net returns to our customers than would have been achieved from buying or selling for a nominal ticket charge without working the issue or from just taking the bonds and the prices that the custodian or clearing firm is offering. It is my opinion that the intrinsic value of this research and negotiation will get commoditized away if this rule takes effect as written, making it uneconomical for brokers that are subjected to the rule to spend the time and energy required to research and negotiate the best bonds for their customers. While big firms will continue to enjoy the same profits on their fixed income trades free from the burdensome requirements of this rule, small firms and their brokers will get squeezed out leaving their customers to take whatever issues and prices the remaining big firms have to offer. Less competition is rarely a good thing for the consumer and that will be the long-term result of this rule if adopted.

Finally, FINRA already has rules in place that protect retail customers by limiting markups, as well as processes in place for disciplining firms that violate these rules. Requiring firms to publish the cost at which they purchase their products (bonds) without regard to the time and effort that goes into finding and procuring those products is onerous and harmful to small businesses like mine that deal in fixed income markets.

If the intent of the proposed rule is to increase customer protection, I believe this objective would be actually be better served by FINRA working with member firms to provide greater clarity with respect to existing rules related to markups. Everyone that I know that trades bonds wants to do the best job they can for their customers and comply with all of the rules and regulations. Rule violations can be prevented and customers can thereby enjoy greater protections if ambiguities in these rules can be resolved and if compliance with the rules becomes less qualitative.

Respectfully submitted,

Scott A. Hayes, CFA
President and CEO
Institutional Securities Corporation

Morgan Stanley
2000 Westchester Avenue
Purchase, NY 10577

Morgan Stanley

January 20, 2015

BY ELECTRONIC MAIL

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

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

MSRB Regulatory Notice 2014-20,
Request for Comment on Draft Rule Amendments to
Require Dealers to Provide Pricing Reference
Information on Retail Customer Confirmations

Dear Ms. Asquith and Mr. Smith:

Morgan Stanley Smith Barney LLC ("MSSB") is pleased to provide comments on behalf of itself and its affiliate, Morgan Stanley & Co LLC ("MSCO" and together with MSSB, "Morgan Stanley"), to the Financial Industry Regulatory Authority's ("FINRA") Regulatory Notice 14-52 and the Municipal Securities Rulemaking Board's ("MSRB") Regulatory Notice 2014-20 (together, the "Proposals").

MSSB is dually registered as a broker-dealer and an investment adviser, and MSCO is a registered broker-dealer. MSSB operates one of the largest wealth management organizations in the world, with over $2.0 trillion in client assets as of December 31, 2014. MSSB offers personalized services to its wealth management clients through its more than 16,000 financial advisors. MSSB and MSCO maintain an extensive inventory of fixed income securities and also source securities from third parties, in each case to provide liquidity on both sides of the market to customers of both broker dealers.

Morgan Stanley supports FINRA's and MSRB's goal of enhancing fixed income price transparency for retail investors and appreciates the opportunity to comment on the Proposals.

Morgan Stanley generally supports the views advanced by the Securities Industry and Financial Markets Association ("SIFMA") in its forthcoming comment letter on the Proposals. However, given the size and unique characteristics of our retail and institutional businesses and our experience in fixed income markets generally, we wish to comment on particular aspects of the Proposals:

1. Matching Methodology and Disclosure

Morgan Stanley is concerned the matching methodology set forth in the Proposals will confuse investors and inaccurately represent a dealer's contemporaneous cost as well as its compensation and transaction costs. In particular, the likelihood of intra-day volatility and the degree of such volatility increases as the window for matching trades increases, such that the matched or "reference transaction" may no longer represent the prevailing market price for the security and the resulting differential may over or understate dealer compensation. Moreover, as a result of the complexity of the matching methodology, investors are not likely to understand why pricing information is disclosed on some trade confirmations and not others, nor what the reference transaction represents or how it was determined for their particular trade (for example, whether a "LIFO" or volume weighted average approach was utilized to match customer trades to a group of reference trades under the FINRA Proposal). In addition, under the Proposals, it is conceivable that similarly situated investors trading on the same side of the market roughly contemporaneously would receive disclosures of different matched trades by application of the methodology or one investor may receive a disclosure while the other does not.

In order to address these concerns with the matching methodology and disclosures, consistent with SIFMA's comment letter on the Proposals, Morgan Stanley would support enhancing TRACE and EMMA and promoting their use by retail customers through investor education. As noted by SIFMA in its comment letter, the MSRB recently acknowledged that the Proposal "would provide investors with information generally already publicly available" on EMMA.[1] Among other important data, TRACE and EMMA provide investors with information concerning the prevailing market price of their securities so they are better positioned to assess the quality of their trade executions and dealer's contemporaneous cost and compensation. Dealers could also assist in this effort by providing links on trade confirmations to TRACE and EMMA.

In light of the Proposals' objective to enhance transparency concerning dealer compensation and transaction costs, Morgan Stanley suggests FINRA and MSRB limit any confirmation disclosure requirement to riskless principal transactions, consistent both with the Securities and Exchange Commission ("SEC") recommendations cited in the Proposals, as well as with existing SEC disclosure requirements for equity securities. While such a disclosure requirement would impose significant implementation costs, it would more accurately represent dealer compensation and transaction costs and address many of the challenges presented by the Proposals as described above and in the SIFMA comment letter. Should FINRA and MSRB extend any disclosure obligation beyond riskless principal transactions, Morgan Stanley urges FINRA and MSRB to narrow substantially the time window during which trades are matched to fifteen minutes, consistent both with the existing timeframe for complying with trade reporting obligations, as well as MSRB's recent study of secondary market transactions in municipal securities which reported that the vast majority of intraday paired trades occur within fifteen

[1] MSRB, 2014 Annual Report at 6.

minutes.[2] While the implementation costs of such a disclosure obligation would be significant, the narrowed time window substantially mitigates the risk of volatility and investor confusion and would also enable FINRA and MSRB to simplify the matching methodology. Alternatively, in lieu of disclosing matching or reference transaction prices, disclosure could consist of the most recent TRACE or EMMA print in the applicable security.

2. Inter-affiliate Transactions

As SIFMA commented, any disclosure obligation should not apply where the customer trade is matched to a trade between the dealer and its affiliate. As described above, MSSB and MSCO fulfill client trades using inventory held by both dealers. The "trade" between these dealers is tantamount to a booking move across entities and should not be construed as a matched or reference transaction under the Proposals. Investors should not receive different disclosures depending upon whether their dealer utilizes the inventory of one or more affiliated entities.

3. Trades with Sophisticated Clients

Morgan Stanley also shares SIFMA's view that in addition to only requiring disclosures for trades below a certain size, specific price reference disclosure should not be required for trades with sophisticated customers (such as qualified purchasers (as defined in Investment Company Act Section 2(a)(51)), institutional accounts (as defined in FINRA Rule 4512(c) and MSRB Rule G-8(a)(xi)) and sophisticated municipal market professionals (as defined in MSRB Rule D-15(a))), regardless of trade size as these customers commonly transact in trade sizes below the threshold in the Proposals. As SIFMA notes, these are established concepts which evidence a regulatory or congressional determination that the clients in question do not require the same type of protection afforded to retail investors. These types of investors have the sophistication to assess pricing and are also more likely to have relationships with multiple dealers and to transact with those that provide more favorable pricing. In addition, utilizing existing sophisticated investor standards that firms already employ within their businesses would simplify implementation in comparison to developing a new definition of retail investor for purposes of the Proposals.

4. Implementation Costs and Challenges

Finally, Morgan Stanley stresses the implementation costs and challenges associated with the Proposals, both for firms individually and when aggregated across the industry. These costs and burdens should be viewed in light of the broader concerns expressed above and in the SIFMA comment letter and should be compared against the costs and benefits of the alternative approaches to increase transparency in the fixed income markets suggested by SIFMA and Morgan Stanley.

[2] MSRB, Report on Secondary Market Trading in the Municipal Securities Market (July 2014), at 24 (Figure III.F).

In conclusion, rather than implement an overly complex, confusing and costly disclosure requirement, Morgan Stanley urges FINRA and MSRB to explore the alternatives suggested by SIFMA and Morgan Stanley to address the policy objectives set forth in the Proposals.

We appreciate the opportunity to provide comments to FINRA and MSRB on the Proposals and look forward to a continuing dialog on this important rulemaking initiative. We would be pleased to discuss any questions FINRA or MSRB may have with respect to this letter.

Respectfully submitted,

Vincent Lumia
Managing Director
Morgan Stanley Smith Barney LLC

BREAN CAPITAL, LLC

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

January 20, 2015

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

Dear Ms. Asquith:

We want to thank you for reaching out to the community of dealers for feedback on its Proposal to TRACE retail-size transactions of fixed income securities.

At Brean, we make markets in, and trade, many smaller pieces of RMBS, CMBS, and ABS securities. As such, we believe we are in a position to comment on the Proposal as it relates to our business. We also have surveyed our customer base about the change in policy to get their feedback, as well. Although we know that FINRA is primarily interested in its dealer reactions, we think actively about our customers and how any market changes might affect them.

Our customer base is strictly institutional. Our accounts have the knowledge and more importantly the systems to analyze these types of securities. And many of these bonds are unique securities unto themselves, with different levels of subordination and different ratings dependent on a whole host of factors. Some class or tranche sizes are very small. And of course some are larger. The general risk surrounding the Proposal pivots on the notion that smaller pieces trade significant discounts to larger pieces. The pricing services rely on TRACE for changes and updates to their own matrices. Let's say an account owns 50mm of a bond, which is priced at 101. They lose an account. A third party liquidator sells 75k current face bid wanted and the bond TRACES at 97-00. Is the 50mm that the Account owns now priced at 97? Imagine this hell-storm going on hundreds of times a month across different securities and almost the entire institutional client base. Tough to adjudicate if you are the money manager who just got written down 4 points on 50mm current face. How does an account get relief?

Today this dramatic and violent repricing of bonds in mutual funds, insurance companies and asset managers does not occur. Tomorrow it might with other unintended and , I dare say, more dire consequences. Put yourselves, for the moment, in the shoes of a risk taker – either a money manager or and dealer. Assume the above example of the 50mm in the customer account and the attendant loss of 75k, 4 points below the last mark. If you are a dealer or ANOTHER customer and you happen to own that same bond.....you may now very well have to mark your position 4 points down. All this is to say that liquidity in the product will surely suffer if repricing can have that kind of impact on P&L. On this point there is little question or doubt.

It is worth noting that, in our opinion, "retail" should not be buying certain esoteric mortgage or amortizing bonds without the ability to understand them. The systems involved cost tens of thousands of dollars annually. As such, at least RMBS,CMBS, and certain ABS classes should be designated institutional and perhaps then not subject to TRACE.

There is certainly more to talk about on this subject. We would welcome any invitation to sit with FINRA to discuss these matters.

Sincerely yours,

John T. Macklin
Director of Operations

Wells Fargo Advisors, LLC
Regulatory Policy
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St. Louis, MO 63103
HO004-095
314-955-2156 (t)
314-955-2928 (f)

Member FINRA/SIPC

January 20, 2015

Via e-mail: ***pubcom@finra.org;***
http://www.msrb.org/CommentForm.aspx

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

Mr. Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

RE: Regulatory Notice 14-52: 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; MSRB Notice 2014-20 - Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations

Dear Ms. Asquith and Mr. Smith:

Wells Fargo Advisors, LLC ("WFA" or the "Firm") appreciates the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA") Proposed Rule Requiring Confirmation Disclosure of Pricing Information in Fixed Income Securities Transactions, set forth in Regulatory Notice 14-52 ("Reg. Notice 14-52") and Municipal Securities Rulemaking Board ("MSRB") Notice 2014-20 ("MSRB Notice 2014-20") Request

for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations (collectively, the "Proposal").[1]

WFA is a dually registered broker-dealer and investment advisor that administers approximately $1.4 trillion in client assets. It employs approximately 15,189 full-service financial advisors in branch offices in all 50 states and 3,472 licensed financial specialists in 6,610 retail bank branches in 29 states.[2] WFA is a non-bank affiliate of Wells Fargo & Company ("Wells Fargo"), whose broker-dealer and asset management affiliates comprise one of the largest retail wealth management, brokerage and retirement providers in the United States. Wells Fargo's brokerage affiliates also include Wells Fargo Advisors Financial Network, LLC, ("WFAFN") and First Clearing, LLC, which provides clearing services to 76 correspondent clients, WFA and WFAFN. For the ease of discussion, this letter will use WFA to refer to all such brokerage operations.

WFA and its affiliates help millions of customers of varying means and investment needs obtain the advice and guidance they need to achieve financial goals. Furthermore, WFA offers access to a full range of investment products and services that retail investors need to pursue these goals.

INTRODUCTION

WFA supports FINRA's and MSRB's objective of improving price transparency in the fixed income markets and applauds efforts to enhance access to meaningful pricing data for retail investors. As a broker-dealer vested with the responsibility of seeking best execution on transactions for over 7.5 million customer accounts, WFA supports regulatory initiatives that will improve the quality of securities and capital markets for retail investors.

While the Proposal's stated aim is theoretically consistent with FINRA's and MSRB's price transparency objectives, from an operational and implementation perspective, it is irredeemably flawed.[3] The plan to provide retail investors with same day price differential information for certain same-day fixed income transactions via dated confirmation disclosures, while sounding deceptively simple to implement, would in fact require overcoming significant technical hurdles. Moreover, the plan would undermine use of more effective price dissemination tools and provide retail investors with confusing or, at worst,

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[1] Regulatory Notice 14-52, 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, November 17, 2014, *available at*: http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p601685.pdf. MSRB Notice 2014-20 - Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations, November 17, 2014, *available at:*http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-20.ashx?n=1.

[2] Wells Fargo & Company ("Wells Fargo") is a diversified financial services company providing banking, insurance, investments, mortgage and consumer and commercial finance throughout the United States of America and internationally. Wells Fargo has 275,000 team members across more than 80 businesses.

[3] Reg. Notice 14-52, at p. 3.

misleading information.[4] Furthermore, the Proposal represents a paradigm shift away from years of regulatory focus on transparency of contemporaneous market conditions at the time of transaction execution. WFA believes investors are best served by continuing to focus on providing meaningful information about contemporaneous market conditions via more advanced near real-time price dissemination tools. Consequently, WFA respectfully recommends the Proposal be withdrawn.

The Proposal's principal flaws include:

- The Proposal's reporting obligations are cost prohibitive and present operational and technical challenges that would be difficult, if not impossible, to effectively implement.
- The Proposal goes far beyond the recommendations included in the Securities and Exchange Commission's ("SEC" or "the Commission") Report on the Municipal Securities Market[5] and is inconsistent with current Exchange Act Rule 10b-10 requirements.
- The Proposal contradicts years of SEC, FINRA and MSRB policy favoring development of price dissemination platforms as a more effective alternative to confirmation disclosure.
- The Proposal provides a distorted view of dealer compensation and diverts attention away from whether a transaction is effected at a fair price relative to contemporaneous market conditions.

Notwithstanding WFA's objections to the Proposal as currently structured, should FINRA and MSRB move forward, WFA stands ready to assist in developing a workable and efficient means of providing greater price transparency for retail investors. WFA believes there are more narrowly tailored alternatives that present an opportunity for FINRA and MSRB to achieve their stated objectives while addressing many of the issues highlighted in this letter, specifically:

- Continued development and expansion of the Trade Reporting and Compliance Engine ("TRACE") and the Electronic Municipal Market Access ("EMMA"®) price dissemination platforms to provide additional near real-time market information to investors.

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[4] The Proposal states that for same-day, retail-size transactions, firms must disclose on the customer confirmation: (1) the price to the customer; (2) the price to the member of a transaction in the same security; and, (3) the differential between those two prices. A "retail-sized transaction" is defined as 100 bonds or less or bonds with a face value of $100,000 or less.

[5] Securities and Exchange Commission Report on the Municipal Securities Market (July 31, 2012), p. 113, *available at*: http://www.sec.gov/news/studies/2012/munireport073112.pdf

- Increased client education to explain how to access and use TRACE and EMMA® along with increased firm usage of links and references to these services in various client communications.
- Confirmation disclosure of riskless principal transaction mark-ups consistent with current Exchange Act Rule 10b-10 disclosure obligations for equity securities.

WFA discusses the challenges presented by the Proposal in greater detail below as well as potential alternatives should FINRA and MSRB determine to move forward.

I. Regulatory Efforts Should Be Focused on Enhancing the Most Effective Methods of Providing Meaningful Price Transparency to Retail Investors.

The Proposal's stated purpose is to enhance disclosure requirements for transactions in fixed income securities that will permit retail investors to "better evaluate their transactions."[6] The policy choices made to ensure retail clients are informed and treated fairly have historically focused on evaluating fixed income transactions against contemporaneous market conditions and establishing price dissemination platforms to promote greater price transparency. WFA believes the Proposal changes the transaction evaluation dynamic and undermines the use of price dissemination platforms by the introduction of a confirmation disclosure that has repeatedly been deemed an inferior alternative.[7] Consequently, WFA believes the Proposal should be withdrawn or, if moved forward, substantially revised.

(a) Focus Should Remain on Value Versus Contemporaneous Market Conditions and Meaningful Disclosure.

As an initial matter, broker-dealers are currently obligated to generally seek the most favorable terms reasonably available in current market conditions for their retail customers' fixed income securities transactions.[8]

This has been a longstanding requirement under FINRA rules[9] and a more recent development under MSRB rules.[10] Historically, MSRB rules required a dealer to provide customers with a "fair and reasonable" price; however, in response to the SEC's 2012 Report on Municipal Securities which recommended certain actions to improve the municipal

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[6] Reg. Notice 14-52, at p.3.
[7] *See* Exchange Act Release No. 33743 (Mar. 9, 1994), 59 FR 12767 (proposing a rule that would have included disclosure of markups for municipal securities transactions); Exchange Act Release No. 15220 (Oct. 6, 1978), 43 FR 47538 (proposing mark-up disclosure for riskless principal trades in municipal securities); Exchange Act Release No. 13661 (June 23, 1977), 42 FR 33348 (proposing mark-up disclosure by non-market makers in riskless principal transactions involving equity and debt securities, but not municipal securities); and Exchange Act Release No. 12806 (Sept. 16, 1976), 41 FR 41432 (proposing mark-up disclosure by non-market makers in riskless principal transactions involving equity and debt securities).
[8] *See* FINRA Rules 5310 and 2121; MSRB Rules G-18 and G-30.
[9] *See* FINRA Rules 5310 and 2121.
[10] *See* MSRB Rules G-18 and G-30.

securities markets,[11] MSRB recently revised MSRB Rule G-18 to explicitly adopt a "best execution" standard for transactions in municipal securities. Moreover, common law duties of best execution have always applied to transactions in municipal fixed income securities.[12] Under common law, when accepting a customer order for execution, the broker-dealer has an implied duty to execute the order in a manner that maximizes the customer's position in the transaction.[13] In all these instances, the regulatory requirements are focused on measuring execution quality in light of contemporaneous market conditions.

WFA does not believe the proposed confirmation disclosure, which includes at-risk as well as riskless transactions, furthers an understanding of contemporaneous market conditions at the time of transaction execution. As currently set forth in the Proposal, however, there is the real possibility a customer may believe the confirmation disclosure represents contemporaneous market conditions or compensation received on riskless transactions. Under this scenario the confirmation disclosure could be thought to portray the prevailing market for the security at the time of execution, which could be inaccurate particularly when the reference trade is not close in time to the customer transaction. Indeed, an intervening market moving event may render the reference price envisioned in the Proposal completely meaningless and misleading.

More customer confusion may result when this information is displayed for only some fixed income transactions while not for others (only disclosed for qualifying transactions). There is also the scenario of a resulting negative spread, which will cause more confusion, particularly if an investor equates the price differential with dealer compensation. Finally, there is a distinct possibility a client could execute a qualifying and a non-qualifying transaction in the same security on the same day. In which case, a client would receive two confirmations, only one of which would disclose a reference price. In other words, the disclosures envisioned in the Proposal may confuse rather than enlighten retail investors. Therefore, investors will be better served by expanding access to price dissemination platforms that provide better insight, in a near real-time manner, into prevailing market conditions than could any reference price.

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[11] *See* SEC Report on the Municipal Securities Market, p.149.

[12] *See Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 273 (3d Cir.), *cert. denied*, 525 U.S. 811 (1998) ("[T]he basis for the duty of best execution is the mutual understanding that the client is engaging in the trade – and retaining the services of the broker as his agent – solely for the purpose of maximizing his own economic benefit, and that the broker receives her compensation because she assists the client in reaching that goal."). This case also recognized that the duty of best execution does not "dissolve" when an intermediary acts in its capacity as a principal. *Id.* at 270 n.1 (citation omitted). *See also* Regulation NMS, Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37538 (June 29, 2005) ("A broker-dealer's duty of best execution derives from common law agency principles and fiduciary obligations, and is incorporated in SRO rules and, through judicial and Commission decisions, the antifraud provisions of the federal securities laws."); Exchange Act Release No. 43963 (Feb. 14, 2001) (citing *Newton*, but concluding that respondent fulfilled his duty of best execution). *See also* Payment for Order Flow, Exchange Act Release No. 34902 (Oct. 27, 1994), 59 FR 55006, 55009 (Nov. 2, 1994) (discussing a broker-dealer's duty of best execution in relation to routing orders).

[13] *See Newton*, *supra* note 12, pp. 269-70.

Furthermore, from what can be gleaned from Reg. Notice 14-52 regarding same-day "matched" transactions, at least with respect to corporate bonds, there generally appears to be tight price dispersion for most transactions, with a minority of transactions experiencing wider price spreads. Given existing execution obligations, the likelihood of customer confusion and generally tight price dispersions, rather than imposing an incredibly complex and costly disclosure requirement on all broker-dealers, FINRA and MSRB should first obtain a better understanding of the reasons underlying these outlier price transactions. FINRA and MSRB can then make a more data informed judgment regarding what, if any, new rulemaking may be appropriate.

(b) Price Dissemination Platforms Have Been Deemed A More Effective Alternative to Confirmation Disclosure.

Since at least 1994, the SEC, FINRA and MSRB have favored development of price dissemination platforms as a more effective alternative to confirmation disclosure. WFA believes these platforms have succeeded in making available a wealth of price information at the click of a button and support the continued enhancement of TRACE and EMMA® as a more efficient and effective alternative than the Proposal. Enhancements to these platforms will put more real-time information in the hands of investors as opposed to the provision of data buried in a dated transaction confirmation.

The Commission in the past considered requiring confirmation disclosure of mark-ups for debt securities, yet in each instance determined not to adopt such a requirement. As early as 1976 the Commission requested comment on whether to require disclosure of mark-ups on riskless principal transactions in municipal and corporate debt securities, yet deferred in part due to cost concerns.[14]

In 1994, the last time this issue was considered, the SEC concluded the price dissemination initiative platforms under development offered "more meaningful benefits to investors in the long-term" than the proposed confirmation disclosure.[15] In the withdrawing release the SEC stated "[t]he Commission has deferred adoption of the riskless principal mark-up disclosure proposal in order to ascertain whether the proposed price information systems can provide more meaningful benefits to investors in the long-term and to assess the progress of the industry in developing the proposed systems. Price transparency, if fully developed, will provide better market information to investors on a timely basis (e.g., before the transaction)."[16] Consequently, WFA believes continued enhancements of TRACE and EMMA® would make more information available to more investors and in a more timely manner than the proposed confirmation disclosure.

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[14] Exchange Act Release No. 12806 (Sept. 16, 1976), 41 FR 41432 (proposing mark-up disclosure by non-market makers in riskless principal transactions involving equity and debt securities).
[15] SEC Final Rule, Confirmation of Transactions, Release No. 34-34962; File No. S7-6-94, p. 12
[16] Confirmation of Transactions, Exchange Act Rel. No. 34962, 59 Fed. Reg. 59,612, 59,616 (Nov. 17, 1994) (withdrawing release).

The period since 1994 has witnessed revolutionary technology innovation that has made electronic access to information via the internet widely accessible. Internet usage has become a normal part of everyday life for many investors with near universal mobile access now available. Indeed, the SEC found over five years ago that a majority of investors rely on the internet to help make investment decisions,[17] while more recent survey data found nearly 90% of adults use the internet.[18] FINRA and MSRB should be commended for using this time to successfully build and implement price dissemination platforms that have dramatically increased near real-time price transparency for retail investors to an extent that could hardly have been imagined in 1994.

This development has not come without cost as the investments needed to build and maintain these systems have been substantial. For example, in 2013 alone, FINRA deployed substantially all of the $58 million it collected in transaction fees to support TRACE.[19] Similarly, MSRB expended close to $14 million in 2013 on operations and market information systems, including EMMA®.[20] Moreover, FINRA and MSRB have plans to enhance these systems to provide greater transparency into market prices.

Furthermore, the broker-dealer community has also separately invested tens of millions of dollars to design, build and implement the infrastructure necessary to identify and report the relevant transaction information and build supervisory and oversight systems to support these activities. WFA will need to continue to spend substantial sums to maintain and upgrade its supporting infrastructure as FINRA and MSRB propose new reporting obligations in addition to the Proposal.

Given existing execution obligations coupled with policy choices and investments in price dissemination platforms that have been deemed superior to confirmation disclosures, WFA believes the most appropriate course is to continue to invest in upgrading TRACE and EMMA® to provide more near-real time information to retail investors free of charge. To implement a costly confirmation disclosure method that has previously been deemed inferior, even prior to the rise of the internet age and the implementation of TRACE and EMMA®, is not the best way to put more information in the hands of investors today.

II. The Proposal Is Cost Prohibitive and Difficult, If Not Impossible, to Effectively Implement.

As discussed above, the proposed confirmation disclosure, while appearing benign, in practice would require overcoming significant technical hurdles and a redesign of the confirmation process.

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[17] Investment Company Act, Rel. No. 28584, 74 Fed. Reg. 4,546, 4,560 n.195 (Jan. 26, 2009).
[18] Pew Research Internet Project, Internet Use Over Time, *available at*: http://www.pewinternet.org/data-trend/internet-use/internet-use-over-time/.
[19] FINRA 2013 Year in Review and Annual Financial Report
[20] MSRB 2013 Annual Report

The confirmation process is already a complicated activity that relies on inputs from multiple systems to generate a transaction confirmation that complies with the various regulatory requirements. These inputs include, but are not limited to, trade files, security master files and customer files. Additional data points include accrued interest, price and yield information and total funds. All the information needed to produce a confirmation is captured at the time of transaction execution, thus permitting firm systems to efficiently process the necessary information for inclusion on a transaction confirmation.[21]

In addition, transaction confirmations have strayed far beyond the original purpose of providing investors with the terms of the transactions. So much so that simply identifying space to provide additional information is becoming problematic. To add more information as set forth in the Proposal without context has the potential for misinterpretation, is a recipe for confusion and is not the most efficient use of resources.

Pursuant to the Proposal, firms would be required to obtain additional information about a reference security and to conduct calculations on the price difference between the reference trade and the customer trade, and display the reference trade price and the difference between the trade price and the customer trade price on the confirmation, along with the customer trade price. To complicate matters, varying amounts of this information may not be available at the time of the transaction. Redesigning confirmation systems to accurately identify and incorporate relevant post execution information, while theoretically possible, would be technically challenging and require time consuming and expensive system upgrades. Moreover, the potential for a shortened trade settlement process would only further exacerbate technical and programming challenges.[22]

To further complicate matters, the Proposal attempts to incorporate into the confirmation generation process various matching methodologies for determining a reference price. Under certain circumstances a firm is obligated to use a "last in first out methodology" while under different circumstances a firm needs to use an average pricing methodology (or first in, first out (FIFO)). To illustrate the issue, Example 7 in Reg. Notice 14-52, states that where there are multiple firm trades which equal the amount of the customer trade, the firm would be required to disclose on the customer confirmation the weighted average price of the Firm trades to the Firm, the price to the customer and the differential between the two prices.

In Examples 9 and 10, 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 apply a last in, first out (LIFO) methodology or the closest time proximity depending on whether the client transaction was before or after the

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[21] There is also a potential impact to the ID confirmation process, wherein it is possible to have transactions effected for 100 bonds or $100,000 or less via delivery versus payment. The ID confirmation process is a real-time process and if trade information is not available until end-of-day, confirmations may need to be canceled and rebilled to include the price reference information. This could result in downstream impacts.

[22] Depository Trust & Clearing Corporation, DTCC Recommends Shortening the U.S. Trade Settlement Cycle (Apr. 2014) (advocating for a move to a two-day settlement period).

Firm's transaction. The Firm would also be required to disclose on the customer confirmation the price to the Firm of the last or closest transaction, the price to the customer, and the differential between the two prices. These examples only begin to cover various permutations when there are multiple customers and multiple transactions involved and do not consider intervening market events that may make the reference price meaningless. Firms generally do not build and offer positions in fixed income securities on a paired transaction basis. It is also unclear how cancellation and correction would be handled, particularly if the underlying cause is a change in the reference security. In any event, systems would need to be able to digest numerous contingencies that together can cause the design and implementation costs to skyrocket. WFA believes that smaller correspondent firms who do not have automated systems will have an even more difficult time in attempting to meet the Proposal's additional requirements on a manual basis.

WFA's early and quick estimate of the costs to design and implementation of system modifications to comply with the Proposal's requirements is approximately $1.5 million dollars.

WFA believes a fulsome cost benefit analysis needs to consider not only the direct technology upgrade costs associated with the Proposal, but also the context of an industry that is subject to multiple competing regulatory initiatives such as the recent expansion of the Order Audit Trail System, the Consolidated Audit Trail, Blue Sheets, Large Trader, Supplemental Statement of Income and potentially FINRA's proposed Comprehensive Automated Risk Data System. In addition, any cost benefit analysis needs to include the tens of millions of dollars already spent developing TRACE and EMMA® as well as planned improvements to these systems that makes near real-time market pricing information available to nearly all investors free of charge.

The cumulative effect of the Proposal combined with other ongoing regulatory efforts is to unnecessarily siphon a firm's finite resources, squeezing out investments that could otherwise be used to enhance broker-dealer operations, surveillance capabilities and the customer experience.[23]

III. The Proposal Undermines Prior/Current Efforts to Provide Greater Price Transparency for Retail Investors, such as TRACE and EMMA®.

WFA believes there are more narrowly tailored alternatives that present an opportunity for FINRA and MSRB to achieve their stated objectives while mitigating many of the issues highlighted in this letter.

[23] A cost analysis should not ignore the contextual backdrop of an industry with multiple regulatory reporting efforts underway (e.g., Consolidated Audit Trail). *See also* SEC Commissioner Daniel Gallagher, Interview at Security Traders Association Market Structure Conference (Oct. 1, 2014) (supporting a holistic review of market structure).

(a) Expand Current Price Dissemination Systems.

WFA believes TRACE and EMMA® are far more useful to retail bond investors than the disclosures outlined in the Proposal because TRACE and EMMA® data is available pre-trade and post-trade, where the information in the Proposal would not reach the retail investor until roughly three days after the trade. As discussed earlier, the SEC, FINRA and MSRB have favored price dissemination platforms over confirmation disclosure for cost *and* benefit purposes. At a time when internet use is ubiquitous, the most effective use of resources is to focus on enhancing those systems deemed to provide investors with the most timely and useful information.

TRACE was approved by the SEC and implemented in 2002 to specifically address issues of transparency in the bond market. TRACE contains: (1) rules that describe which bond transactions must be publicly reported and when; and, (2) a technology platform that gathers transaction data and makes it available to the public. According to FINRA, TRACE "helps create a level playing field for all market participants by providing comprehensive, real-time access to public bond price information."[24] As noted previously, on a number of occasions prior to TRACE enactment, the SEC considered and rejected confirmation disclosure mark-ups, stating that price transparency initiatives underway by FINRA, specifically referencing TRACE, promised "more meaningful benefits to investors in the long-term" than the proposed confirmation disclosure. [25]

EMMA® is the official repository for information on virtually all municipal securities. EMMA® provides public access to official disclosures, trade data, credit ranges, educational materials and other information about the municipal securities market free of charge. This system houses municipal disclosure documents that provide information for investors about municipal securities, including offering documents for most new offerings of municipal bonds, notes, 529 college savings plans and other municipal securities issued since 1990. With respect to market transparency, EMMA® provides retail customers with real-time prices and yields at which bonds and notes are bought and sold, for most trades occurring on or after January 31, 2005.

WFA is unaware of any current or ongoing issues with lack of information for retail investors in fixed income markets. Further, FINRA has not provided any statistical information that retail investors are unable to obtain relevant pricing information prior to trading fixed income products.

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[24] FINRA,TRACE Fact Book 2013 at 2**.** Items disclosed in TRACE include, but are not limited to: all transactions in a particular CUSIP by date and time, the price of every transaction, information about the quantity of transactions, whether a transaction was with a dealer or customer, information about the bond's yield, and information about the bond and issuer itself that may bear on prices and likely yields.

[25] SEC Final Rule, Confirmation of Transactions, Release No. 34-34962; File No. S7-6-94, p. 12.

WFA believes continued enhancement of TRACE and EMMA®, at a time of near universal access to and use of the internet, is the best means of providing meaningful transparency regarding contemporaneous market conditions to more investors and in a more timely manner than the Proposal's confirmation disclosure of artificial reference price data.

(b) Direct Confirmation Disclosure to Riskless Transactions.

Both FINRA and MSRB have cited the SEC's Report on the Municipal Securities Market and the June 20, 2014, speech given by SEC Chair Mary Jo White as a basis for the Proposal.[26] The Proposal however goes far beyond the recommendations contained in the Report on the Municipal Securities Market and discussed by Chair White. While not ideal, WFA believes a proposal that conforms to the recommendations regarding additional disclosure in "riskless principal" transactions as set forth in the Report and in Chair White's speech would at least be a workable alternative.

Confirmation disclosure of price differentials on riskless principal transactions would simplify the confirmation generation process and provide investors with information unimpeded by hedging or market factors that could lead to misinterpretation of the mark-up information. The confirmation disclosures should be applicable to "riskless principal" transactions as previously set forth by the Commission,[27] wherein the broker-dealer has an "order in hand" at the time of execution. The broker-dealer would have all the necessary information at the time of trade to initiate the confirmation generation process, somewhat simplifying the technical and programming challenges for implementing system upgrades.

The SEC,[28] FINRA[29] and MSRB[30] have all historically recognized the predicate qualification of having an order in hand to appropriately be deemed a riskless principal

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[26] Securities and Exchange Commission Report on the Municipal Securities Market (July 31, 2012), p. 113, *available at*: http://www.sec.gov/news/studies/2012/munireport073112.pdf. In a June 20, 2014 speech, SEC Chair Mary Jo White announced support for additional disclosures to help investors better understand the costs of their fixed income transactions. *See Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors*, Economic Club of New York, New York, New York, *available at*: http://www.sec.gov/News/Speech/Detail/Speech/1370542122012.

[27] Securities Confirmations, Exchange Act Rel. No. 13661, 42 Fed. Reg. 33,348 (June 30, 1077) (proposing release).

[28] Exchange Act Rule 10b-10(a)(2)(ii)(A) applies to circumstances in which a "broker or dealer [that] is not a market maker in an equity security and, if, after having received an order to buy from a customer, the broker or dealer purchased the equity security from another person to offset a contemporaneous sale to such customer, the broker or dealer sold the security to another person to offset a contemporaneous purchase from such customer."

[29] FINRA Rule 6282(d)(3)(B) ("A 'riskless' principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell.").

[30] MSRB Notice 2010-10 (Apr. 21, 2010). MSRB defined a "riskless principal transaction" as "a transaction in which, after receiving an order from a customer, the dealer purchased the security from another person to offset a contemporaneous sale to such customer or, having received an order to sell from a customer, the dealer sold the security to another person to offset a contemporaneous purchase from such customer."

transaction. Moreover, this definition of riskless principal transaction would provide consistency with Exchange Act Rule 10b-10 requirements as applied to equity transactions.

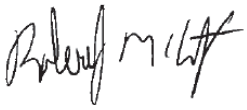
WFA does not believe confirmation disclosure on riskless principal transactions is the ideal solution. Such proposals have been withdrawn in the past because of cost and benefit considerations and still needs to be subjected to a cost-benefit analysis. Even moving forward with confirmation disclosures on riskless principal transactions will still require process changes and, although of lesser cost than the process contemplated under the Proposal, relatively expensive system changes.

Consequently, should FINRA and MSRB move forward with their respective proposals, WFA requests that any further publications are issued via a joint release that contains the same information and use of terms to ensure a standard and consistent approach. This would contain costs, minimize system changes and ensure uniformity in application.

CONCLUSION

WFA appreciates the opportunity to respond to the Proposals issued by FINRA and MSRB. Although WFA believes the Proposal as currently structured should be withdrawn, WFA remains willing to aid FINRA and MSRB in achieving greater price transparency for retail investors. WFA welcomes additional opportunities to respond as the Proposal evolves. If you would like to further discuss this issue, please contact the undersigned at 314-955-2156, or robert.j.mccarthy@wellsfargoadvisors.com.

Sincerely,



Robert J. McCarthy
Director of Regulatory Policy

January 16, 2015

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

Ms. Asquith:

Thank you for the opportunity to comment on proposed amendments to Rule 2232 that would require mark-up disclosure for retail size transactions where the purchase and sale of the security occur on the same day. Despite repeated denials and claims to the contrary, regulators truly believe that retail investors are paying too much for fixed income securities. Consequently, in an effort to provide investors information similar to that received on agency equity transactions, regulators have long sought a method of requiring disclosure related to what have heretofore been described as "riskless" principal transactions in fixed income securities. This desire usually manifested itself in proposals requiring markup disclosures for "riskless" principal transactions, which were always defined as transactions that clearly contained risk. The current proposal is an improvement in at least that regard as it does not attempt to define a lynchpin term as something it is not.

I would be tilting at windmills if I were to devote any more time to besmirching the idea of requiring dealers to disclose the price at which inventory was acquired. That ship has sailed. Nevertheless, there are still a number of issues with the current proposal that need to be addressed in order to ensure that the information provided to investors is accurate and educational, and does not represent a burden that falls unequally on certain broker-dealers.

First, the proposed amendments do not address issues raised by the sale of securities out of new issues at the public offering price. If a security is purchased at the public offering price on the day of issue, the amount of profit earned by the syndicate or selling group member should be irrelevant to the client acquiring the security. By rule, the public offering price is no respecter of the nature of a particular purchaser, unless the purchaser is a broker-dealer. Furthermore, calculating the exact amount of profit attributable to the sale is complicated by the nature of syndicate roles and the amount of the members' profits attributable to investment banking activity. The Board should consider including an exemption in the proposed amendments that would not require a broker-dealer to disclose "mark-up" on transactions in new issues executed at the public offering price on the date of the issue's sale.

Also, in order to achieve the Board's stated intentions, the proposed amendments should address transactions that represent principal value of $100,000 or less in addition to those that involve 100 bonds or $100,000 par value or less. Transactions in zero coupon bonds with par value well in excess of $100,000 have principal amounts traded well below $100,000. A transaction involving $250,000 par value of a zero coupon bond maturing in 30 years, priced to yield 6.00 percent would only involve about $42,000. I believe that the Board would consider this to be a retail size transaction. Far be it from me to advocate expansion of the applicability of an undesirable regulation; however, I believe that this was drafting oversight that the Board would want to correct. Additionally, if not corrected there would likely be a considerable increase in activity in zero coupon bonds in an effort to avoid the new requirements.

The proposal could result in an increase in prices paid by retail investors in general, since there will be more than a small chance that more than a few dealers will require that retail size sales to customers will not be permitted until the opening of business on the day following the purchase of the bonds. In instances where the dealer has acquired a block larger than "retail size", institutional clients will have access to inventory prior to the inventory being offered to retail clients. The result being that retail clients will only see inventory that did not represent value to institutional clients that were offered the security on the previous day. This might not be solely the result of larger dealers utilizing capital to avoid disclosure requirements. There will be some small dealers that may be forced to adopt this policy because they cannot afford the expense involved in programming the information necessary to accurately disclose the required information.

The request for comment inquires as to whether or not an alternate definition of reference price would be preferable to the definition proposed. Any definition of the reference price that would require a dealer to go outside the universe of its own trades would unnecessarily increase the cost associated with what will already be a burdensome task. Furthermore, the definition needs to be very clear in how price and mark-up are defined, so that an investor knows exactly what is represented by the amount of mark-up disclosed and can be confident that that amount is calculated in the same manner regardless of the client's counterparty. The idea of a *de minimis* exception holds promise, particularly if the *de minimis* amount is a flat dollar amount rather than a per bond figure.

Research has certainly revealed that the average retail customer is being charged fixed income mark-ups that regulators find unpalatable. It is difficult to determine which of a number of factors including investor apathy, which this proposal is designed to address, is centrally responsible. However, it is quite likely that firms that are charging mark-ups that regulators find generally unpalatable (although certainly not excessive) will not be deterred by the proposal. There are steps that could have been taken to improve investor education without requiring sellers to disclose the cost of their inventory on a confirmation.

I do not believe that the proposal will accomplish the goal that the Board has established. However, I am reminded of an old friend who would not eat mushrooms because he refused to eat anything the sun killed: it is difficult to oppose bringing sunlight to anything. Unfortunately, I do not believe that light of this nature will open many eyes, and will create unnecessary confusion and unintended consequences if some of the issues I have raised are not addressed.

Sincerely,

Chris Melton
Executive Vice President
Coastal Securities

SUTTER SECURITIES INCORPORATED

January 20, 2015

Marcia F. 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:

FINRA has requested comment on a proposed rule requiring confirmation disclosure of pricing information in fixed income securities transactions. My comments would apply to most fixed-income securities but my emphasis is primarily on municipal securities.

In setting forth the "*Need for the Rule*", FINRA states that the new disclosure *"will provide customers with meaningful and useful information*". Further, FINRA states that *"this additional pricing information will better enable customers to evaluate the cost and quality of the services firms provide…."*

I do not agree with these statements for reasons set forth below.

The municipal market is a $3.8 trillion market and there are about 60,000 different municipal bond issuers. Although the overall municipal market is very liquid, most issues trade infrequently. Within a given rating and maturity, a municipal bond will trade based upon its yield to maturity ("YTM"). YTM is currently provided to all customers on their trade confirmation and is calculated after all costs, including mark-ups. Understanding a bond's structure, call features and risk often requires the broker to do far more "homework" than required in recommending an equity security.

In most cases when a retail customer purchases an equity security their objective is to eventually sell the security at a higher price. Clearly, knowing the commissions are an important factor in the "buy/sell" decision. In addition, it is relatively easy for a retail customer or a broker to get in-depth information on an equity security. (OTC-BB aside).

This is not the case with the overwhelming majority of municipal bonds.

When the retail customer purchases a municipal bond they are rarely buying with the intent of selling it at a higher price. Municipal bonds are bought with the intent of holding the bond until they are called or to maturity. In concluding that disclosing the "mark-up" or "mark-down" on a fixed-income trade would provide meaningful and useful information, FINRA is treating these costs in the same manner as the commissions charged on an equity trade.

A mark-up of $500 on the purchase of 50 bonds with three years to maturity has a higher cost to the customer than a mark-up of $500 on the purchase of 50 bonds with ten years to maturity! Merely highlighting the mark-up can be misleading.

Let's look at a two hypothetical examples:

220 MONTGOMERY STREET • SUITE 1700 • SAN FRANCISCO, CA 94104-3539
415-352-6300 • 800-568-2372 • FAX 415-352-6333
www.suttersecurities.com

Example 1: Firm A buys 50 XYZ bonds from a dealer with a 3.0 % coupon and a maturity of 1-15-2018 (3 years) at a price of 100. The same day, Firm A sells the bonds to one customer at 101. The confirmation will show a yield to maturity of 2.64%. If the bonds were sold at 102, the yield to maturity would be 2.30%. The difference is 0.34%.

Example 2: Firm A buys 50 XYZ bonds from a dealer with a 3.0 % coupon and a maturity of 1-15-2025 (10 years) at a price of 100. The same day, Firm A sells the bonds to one customer at 101.The confirmation will show a yield to maturity of 2.88%. If the bonds were sold at 102, the yield to maturity would 2.77%. The difference is a relatively small, 0.11%.

As shown in this example, the true "cost to the customer" is not determined by the mark-up alone but by the impact of the yield to maturity calculation!

In addition to not providing truly useful information, I believe there may be significant unintended consequences from the current proposal. Whenever feasible, firms will establish "inventory accounts" so that they may hold bonds overnight. How has the retail customer benefited by having the broker wait one day before offering the bond to the customer?

In addition, there is now an incentive for the broker to concentrate a client's holdings by acquiring positions in excess of $100,000 at a time. Where a client may be better served by holding six $50,000 positions, they may be offered two $150,000 positions so as to avoid the additional disclosure.

Finally, the impact of this proposal will be most significant on the small firm. It is estimated that the number of small firms has decreased by more than 1000 in the past 5+ years. In part, this was caused by the dramatic drop in equity commissions. It is the rare broker that can make a living at $.01/share (or less). Hence the dramatic increase in the number of managed accounts where no one questions a one percent annual management fee. Today, by doing research and working closely with a retail client, a broker can still make a reasonable living with a municipal bond clientele. This can be accomplished with reasonable mark-ups, not exceeding three percent – and usually far lower. If there is a required disclosure of mark-ups, the most likely result will be significantly lower income to the broker-dealer and the broker. Many smaller firms are likely to merge or go out of business. More brokers will opt to become Registered Investment Advisors.

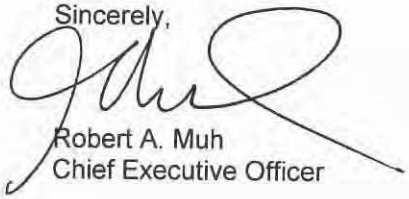
Is the public really better served by having fewer firms and brokers available to service the small retail account?

In spite of my compelling arguments against this proposal, I fear that this train has already left the station. Consequently, if disclosure is going to be required, I would suggest a modification to the current proposal. Namely, I would propose that disclosure be based upon a combination of the bond maturity and the mark-up. For example, disclosure might be required in the following cases:

1. Any mark up of 1.0% or more on a bond maturing in less than three years
2. Any mark up of 2.0% or more on a bond maturing in less than ten years
3. Any mark-up of 3.0% or more.

The specific numbers may be adjusted based upon trading and mark-up statistics available to FIRNA. Because many municipal bonds require significant analysis to understand their credit risk, likelihood of an early call and bond structure, there will be transactions where a higher mark-up is justified.

Sincerely,



Robert A. Muh
Chief Executive Officer

BDA Bond Dealers of America

21 Dupont Circle, NW • Suite 750
Washington, DC 20036
202.204.7900
www.bdamerica.org

January 20, 2015

VIA ELECTRONIC MAIL

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

RE: **FINRA Regulatory Notice 14-52: FINRA Requests Comment on a Proposed Rule Requiring Confirmation Disclosure of Pricing Information in Fixed Income Securities Transactions**

Dear Ms. Asquith:

On behalf of the Bond Dealers of America ("BDA"), I am pleased to submit this letter in response to the Financial Industry Regulatory Authority's ("FINRA") Regulatory Notice 14-52 (the "Notice"), requesting comment on a proposed rule to require the disclosure of pricing reference information on trade confirmations for certain 'retail-size' fixed-income securities transactions. BDA is the only DC based group representing the interests of middle-market securities dealers and banks focused on the United States fixed-income markets and we welcome this opportunity to present our comments on the Notice.

BDA is concerned that regulators may move forward with this pricing reference disclosure rule without fully appreciating the complexity of the proposal from an operational and systems standpoint and without first engaging in a study that would inform regulators about the potential for this proposal to cause harm and confusion to investors, dealers, and the marketplace. Therefore, BDA urges regulators to engage in a feasibility study in order to begin to explore the inherent complexities of the proposed rule. Importantly, the feasibility study will create a valuable opportunity for regulators, dealers, and investors to explore enhancements to EMMA and TRACE that would serve as a cost-effective alternative to the disclosure described in the proposed rule.

BDA supports measures to increase pricing transparency for retail fixed-income investors. However, BDA is extremely concerned by the fact that the Notice lacks any discussion of how the proposed rule will actually function in the context of the systems currently used by dealers. While the description of the rationale that governs the disclosure methodology is clear what is not explored in the Notice is how difficult and

costly it will be for dealers to integrate this logic into their various trading and operational systems. Dealers will have to make alterations to operations, technology, clearing, and trading systems, in addition to third-party-vendor-provided services. The cost burdens associated with these changes will be significant for dealers, especially small-to-medium sized dealers. The Notice fails to fully contemplate these changes or their associated costs.

Without a full discovery of these complexities and the rule's possible negative investor impacts, preparing a comprehensive economic and operational analysis of the rule's impact is impossible. If, after completing a full discovery process, regulators chose to re-propose the pricing reference disclosure rule rather than working to create alternative solutions through enhancements to the functionality of EMMA and TRACE, regulators should allow for an additional comment period.

The proposed rule lacks a discussion of the various operational and technology obstacles for accurately capturing specific trade details for a specialized universe of trades, listing that information on a confirmation, and delivering that confirmation to the customer.

The Notice describes the logic that will be used to identify a universe of trades that will require a special confirmation disclosure. However, the rule does not discuss how FINRA and MSRB—based on their understanding of the trading, operational, and clearing systems currently used by dealers—believe it is feasible for dealers to seamlessly integrate the proposed rule's logic into their current systems in order to accomplish what is described in the Notice or what the associated cost burdens of doing so could be.

Listed below are some of the most significant and costly changes dealers will have to make in order to comply.

- Dealers will have to build new systems designed to capture the rule's required data elements in front and back-end systems.
- Dealers will be required to re-design front-end trading systems and back-office Service Bureau systems to operate with new matching logic. This system will need to be designed to run in real-time and will link dealer activity with customer trading activity. (This aspect of the rule will be especially problematic for firms, especially when applying the logic in real-time while executing significant buying and selling of securities at a variety of sizes and prices. For smaller firms, that may have to perform these types of tasks manually this could present a devastating technology and compliance burden. In some cases, smaller firms depend on vendors who may not even be willing to perform the tasks.)
- Dealers will have to design systems that work with batched trade files to identify—on a CUSIP-by-CUSIP basis—principal trades and associated retail trades. Then, at the end of the trading day, the system will have to apply the proper LIFO, closest in time, or average price methodology (based on FINRA's currently proposed rule) depending on how the principal position was accrued and the aggregate quantities of the retail-size trades. This is a system that does not

currently exist.

- Dealers may have to completely re-design their trade confirmations in order to comply with the rule's requirements. Trade confirmations have limited physical space to display the disclosures currently required under existing, applicable confirmation disclosure rules. Adding yet another required disclosure element will further challenge the finite confirm space availability, and at some point will yield diminishing returns to the investor as a disclosure piece due to the volume of information presented and the manner in which it must be presented to fit in the physical space.
- Trade files and reports will have to be enhanced in order to supervise compliance with the proposed rule change.
- Dealers will have to engage various third-party vendors to design solutions that will work in tandem with the various third-party-provided services and systems dealers currently use.

BDA believes that the proposed rule's universe of associated principal and retail trades is too broad and is not based on any empirical, market-based analysis.

BDA believes that, as currently designed, the rule would require disclosures that may not convey useful or complete information to retail investors. BDA believes that retail investors will ultimately ignore a disclosure that is confusing and applied without understandable consistency.

As Example 3 on page 4 of FINRA's Notice describes the reporting obligation for a firm that enters into a trade, in a principal capacity, to buy 500 bonds for 100 per bond. Then, on the same trading day, the dealer sells 30 of those bonds in a retail-sized transaction for 102.5 per bond. As the example states, the proposed rule would require a price differential disclosure of 2.50 on the retail trade confirmation.

This proposed disclosure requirement would inform the retail investor of the same-day price reference associated with the 30-bond purchase. But, this disclosure would not create a complete picture of the risks associated with this trade. The disclosure fails to provide the retail investor with a comprehensive disclosure because it does not adequately capture a holistic picture of the market risks and costs to the dealer for continuing to carry $469,250 of bonds in inventory for an undetermined period of time.

In this instance, if the retail customer scrutinized their dealer-provided trade confirm they would see the 2.50 ($750) pricing differential. However, the retail investor would be unaware that the dealer still held 94% of the original principal transaction in inventory. Carrying inventory carries significant risks. Profits are not guaranteed for the dealer. Dealers accept these risks in order to earn reasonable compensation in the service of their retail customers. BDA rejects the notion that principal trades entered into by dealers who chose to use their limited balance sheet capacity to service potential customer demand in the future are "riskless." These trades are not the functional equivalent of agency trades and should not be treated as such. BDA is concerned that this

disclosure could give investors the false impression that these trades are "riskless" thereby reducing investor confidence in the marketplace.

Furthermore, compensation, earned in compliance with the dealer's best execution responsibilities, helps to pay for the costs including but not limited to operations, sales, compliance, and trading personnel, credit analysts, providing retail investors with trade confirmations, monthly, quarterly, and annual statements, CUSIP fees, and the cost of trading technology services. These risks and costs are not disclosed to the retail investor, which creates an incomplete and misleading reference for the retail customer and the dealer, especially when the dealer holds inventory for any period of time.

As FINRA's rule states, "FINRA has observed that over 60 percent of retail-size trades had corresponding principal trades on the same trading day. In over 88 percent of these events, the principal and customer trades occurred within thirty minutes of each other." If this timescale captures the vast majority of the universe of trades that regulators seek an enhanced disclosure in relation to, BDA urges regulators to provide an empirical, market-based rationale for why designing the disclosure to apply in a full-day trading range is their preferred methodology.

BDA believes the proposed rule will provide a disclosure that may confuse investors and will not enhance investor understanding of the market generally.

The Overview to MSRB's rule states: *"This potential disclosure, made in connection with the investor's transaction, may be significantly beneficial for the purposes of the investor's understanding of the market for the traded security."*

The Background and Discussion of FINRA's rule states: *"FINRA has also observed that while many of these trades have apparent mark-ups within a close range, significant outliers exist, indicating customers in those trades paid considerably more than customers in other similar trades."*

The quotes above both allude to a comparative value analysis not between dealer cost basis and investor cost but, rather, between investor cost and the costs of other investors entering into "similar trades" in the market during a similar timeframe—"the market for the traded security."

Prices in the fixed income market are dynamic. A dealer may purchase bonds at 99 in a principal capacity prior to a market-moving event and then enter into a sale, possibly hours after the initial transaction, at a 102 in full compliance with the dealer's best execution responsibilities. At that point, another dealer could be executing comparable retail-size sales at 102.5 or 103 with a cost-basis (for disclosure purposes) of 101.

BDA notes that the disclosure—by definition—is based on where the market was rather than on the actual market conditions at the time of the executed trade. This creates

the opportunity for a highly misleading disclosure. In this instance, the dealer that filled the customer order at the superior market price will be required to disclose a larger markup than the dealer that filled the customer order at the inferior price. The potential impact on the market that could be caused by providing this misleading information to investors is currently unknown and should be studied fully for the benefit of investors and the marketplace.

Furthermore, BDA notes, that if the disclosure were required to be based on LIFO, average price, or the closest in time standard depending on trade size and how the dealer accrues the principal position, three identical retail-size investor trades would receive three completely different pricing reference disclosures which adds an additional layer of potential confusion for investors.

BDA strongly recommends that FINRA and MSRB engage in a feasibility study to discover and evaluate the various practical challenges this highly complex rule presents.

Due to the fact that the proposed rule does not contain a discussion of what the proposed rule would entail from a technology and operational standpoint, BDA recommends FINRA and MSRB develop a feasibility study to explore what the optimal method for providing investors with greater market transparency could be. BDA is especially concerned with how this proposed rule will impact the competitive position of small-to-medium sized dealers. As stated above, BDA urges regulators to resubmit the pricing reference disclosure rule for comment after engaging in a comprehensive feasibility study.

Furthermore, as part of the study, BDA urges FINRA and MSRB to seek the input of the third-party vendors that dealers rely on to provide trading, technology, accounting, operations, and clearing services. While FINRA and MSRB are not required to perform outreach to these critical providers of services to dealers, the success of this rule will ultimately depend on the ability of these service providers to work with dealers and to configure their systems to allow efficient implementation and compliance to occur.

As BDA discussed above, FINRA and MSRB have not fully explored what this rule means for dealers on a practical day-to-day basis. The discovery process engendered by a feasibility study will allow for an assessment of what this rule would actually mean from an operational, technology, and trading systems standpoint. This will allow regulators to have greater insight into the systems on which they have proposed dealers make significant alterations. Additionally, BDA suggests FINRA and MSRB to actively seek the expertise of clearing firms and third party technology vendors to assess the feasibility of the rule and to discuss the operational and technological obstacles to expeditious dealer compliance.

This study should also provide an opportunity to explore ways to enhance TRACE and EMMA and explore why investors are not accessing these websites to evaluate the comparative value of their trades compared to similar-sized trades executed

in the market during similar timeframes. This study presents an opportunity for regulators to engage with investors and dealers in order to enhance EMMA and TRACE rather than requiring an additional disclosure prior to understanding why investors routinely ignore, or fail to seek, the market data that would naturally enhance their understanding of the market.

BDA suggests allowing dealers to employ whichever pricing disclosure methodology is the most efficient, least-cost method that fully complies with the dealer's responsibilities under the proposed rule.

If, after competing a comprehensive feasibility study, FINRA and MSRB present a detailed, market-based justification for why implementing a rule similar to the proposed rule is optimal for investors and the market, BDA recommends that FINRA allow dealers to choose the disclosure methodology of their choice. This will allow dealers to utilize the disclosure methodology that works most effectively with their existing systems. Dealers should be allowed to disclose the price differential in percentage spread, dollar terms, price differential, or yield terms. From a cost accounting standpoint, dealers should likewise be able to assess the functionality of their current systems and chose to make the reference disclosure using a weighted average, LIFO, FIFO, or closest in time proximity depending on what method works with their existing system capabilities.

The rule should contain some exclusions.

The rule should not apply to institutional investors. The rule operates to protect mainly retail investors through its application only to small trade sizes. The rule, though, should specifically exclude coverage to institutional investors so that dealers are able to categorically exclude those trades from coverage.

The rule should specifically exclude trades in connection with primary offerings. Distributions in connection with primary offerings benefit from offering memoranda that offer ample disclosure concerning the offering. Accordingly, trades by dealers in connection with distributions of securities in connection with primary offerings should be excluded from the coverage of the rule.

Thank you again for the opportunity to submit these comments.

Sincerely,

Michael Nicholas
Chief Executive Officer

In what other industry do we demand to see the seller's cost of every item we purchase? Must we know the grocery store's cost to make an informed decision as to whether we want to buy milk? Must we know the gas station's cost to make an informed decision as to whether we want to buy gas? No, we make those decisions based on perceived value. The milk buyer bases their decision not on the cost to the grocer, but on numerous other factors, perhaps the most important being the stores' convenient location. The muni bond investor has plenty of information on which to base a buy decision – yield, issuer, rating, years to maturity, quality of research provided by the registered rep, frequency of trades, etc. If they feel they are not getting a good deal they can take their business elsewhere, just as the buyer of a gallon of milk. To argue that a purchaser cannot possibly make an informed buying decision unless they know the seller's cost is to imply that an exact cost breakdown needs to be provided for every single product that is sold. More disclosure ALWAYS sounds like a good thing. Who could be against more disclosure unless they are doing something nefarious which must be hidden from the public? But if more disclosure leads to unnecessary adversarial confrontations does the client benefit? If clients are so inundated with disclosure that they ignore it all and truly are taken advantage of, is the unethical behavior "all good" because it was disclosed somewhere in the fine print? If the registered rep says that selling individual bonds is not worth the hassle, and offers bond mutual funds as the only fixed income option, did the investor come out ahead? Ever more disclosure is not a panacea for the ills of society and can lead to some very negative unintended consequences. There are plenty of bad players and bad practices for regulators to focus on. There is no need to create a problem where none existed simply to earn credit for solving it.

Michael S. Nichols, Ph.D.
Principal / Financial Advisor

www.cutteradvisors.com[cutteradvisors.com]

Cutter Advisors Group

We were part of the team that assisted in drafting SIFMA's response to FINRA's proposal to require confirmation disclosure on pricing information in fixed income securities transactions. We wish to give our full support of the positions stated in that comment letter.

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January 19, 2015

FINRA Public Comments
c/o Marcia Asquith
Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1506

Ladies and Gentlemen:

I am pleased to comment on **FINRA Rule Proposal 14-52**, *Pricing Disclosure in the Fixed Income Markets*.

Romano Wealth Management is a 53 year old firm having prided itself on an impeccable reputation and no regulatory or customer complaints on record throughout its history. We have managed that feat by treating our clients fairly based on the way we would want to be treated, and believe that the vast majority of broker-dealers operate under this same principal. We oversee $1 billion dollars in client assets and create customized portfolios for retail investors using individual stocks and bonds as opposed to the more common approach of using financial products or third party asset managers. In this capacity, we are extremely active in the fixed income arena for corporate, municipal, and government agency securities, both on the inter-dealer market and in transactions with retail customers.

From the perspective of an active participant in this marketplace, let me state for the record that I find this rule proposal deeply troubling. I think it is misguided, patently unfair, anti-business, anti-free market, and overreaching.

FINRA begins its case stating in the rule proposal that by:

> ...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.

My response to this is, so what? Why is this relevant information? Nowhere in the rule proposal can I find an answer to this question.

So I posed this question to FINRA staff, and the discussion began by citing the number of times examiners walk into a firm and see a two or three percent markup for something in inventory for 15 minutes. Again, why is timeframe relevant? By focusing on markup and specifically only *gross* profit, it implies that the greater profit (and not the actual *net* profit) must mean that something nefarious is taking place. In focusing on gross vs. net profit, it avoids all other factors, like expenses (particularly the

increasing of regulatory compliance for one) and the general cost of doing business, like overhead. This is insulting to the plight of any business owner.

In addition, it ignores that in reality the *net* profit margin of the firm might be only 10% of the *gross* profit. Said differently, in this case it implies that the client is receiving meaningless data that overstates the actual profit by 90% or more!

Let me state that I am not an advocate for egregious markups and we would not have the reputation we covet were this the case. Suffice it to say, neither is FINRA, as this proposal is clearly focused (almost solely I might add) on markup transparency. The proposal continues in its background section:

> FINRA also has observed that while many of these trades have apparent mark-ups with a close range, significant outliers exist, indicating that customers in those trades paid considerably more than customers in other similar trades.

First, the real issue here is that of the "outliers", and we would agree that egregious markups are not in the best interest of the investing public, or honest broker dealers for that matter. However, FINRA already has at its disposal the tools necessary to combat such egregious markups. It has a long standing published markup policy and has clarified this rule from time to time to reflect the current market environment.

Second, FINRA already has in place effective market surveillance capabilities. As just one example, one area where firms already receive routine inquiries from FINRA are in regards to pricing on bonds at a slight premium with short term calls involving negative yields to call. This results in the potential for insignificant dollar loss to the client but significant negative yield due to the proximity to the near term call when calculated on a daily compounded basis. While this may not look good on an absolute basis it can have significant upside to the client with limited or insignificant downside. It is an appropriate issue to be flagged at its surface, but easily explained away. I cite this as an example of effective regulatory practices, and representative of the process that already takes place to protect the investing public.

Third, FINRA already has TRACE (and the municipal markets have the equivalent in EMMA), which is intended to give the investing public better trade and pricing transparency. FINRA acknowledges that all of the pertinent information is already disclosed, but then immediately dismisses it stating:

> 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.

This then, becomes the basis for the proposed rule at hand. Presumably because the investing public does not consult readily available TRACE data, the rule proposal cites Mary Jo White's speech given on June 20, 2014 where the proposal summarizes:

> 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 ***to help customers asses the reasonableness of their dealer's***

> ***compensation*** [emphasis my own], as riskless principal transactions become more common in the fixed income markets.

And there we have it, as therein lies the genesis for current rule proposal 14-52, which then continues to almost exclusively focus on dealer compensation and markup under the cloak of "additional pricing disclosure" throughout. But I ask bluntly, is it the role of Chairman White, the SEC itself, FINRA, the MSRB or any other regulatory agency for that matter to determine the reasonableness of compensation? Under what authority? And moreover how? By forcing the broker dealer to reveal *gross* profit that ignores expense and as already mentioned the cost of doing business and overhead??? I believe this to be a blatant abuse of authority at its worst and a severe overreach at its best, but that question is left for the attorneys to resolve.

More importantly, this proposed rule is simply misguided and off base. Markup and gross profit is not only out of reach, it is not the most relevant factor. The most relevant and determining factor is the end price to the retail client! This is the basis for which the total return to the client (yield) is determined, including markup, and is the sole basis for which a retail investor can reasonably base the quality of his or her execution when compared to other priced transactions in the same security.

Consider the following simple example, which while fictitious, routinely happens at our trading desk:

Romano Wealth Management's (RWM) fixed income trader sees an offering from another dealer for a $200,000 block of highly rated municipal bonds at a price of 102. After some haggling with that dealer, RWMs fixed income trader is able to bid the bonds back and buy $100,000 of the $200,000 piece at a price of 101. Romano's fixed income trader takes the position into inventory and then notifies it sales force, and RWM's financial advisors contact their clients to explain the offering and sell the bonds. Of course, those advisors know their clients and product suitability rules and after several hours it places all bonds to several different clients it knows would be interested in a bond of such quality and duration at a price of 102, for a markup of one point and a *gross* profit of $1,000 to the firm.

Shortly thereafter, a bond trader from another firm buys the remaining $100,000 piece from the original dealer. However, that trader buys the bonds at the original and still displayed offering price of 102. It then immediately sells the client bonds to Mrs. Smith, a customer of the firm at a price of 102.50, for a *gross* profit $500.

So which client is better off, the clients at Romano where the firm had a *gross* profit of $1,000 or Mrs. Jones, where her firm had *gross* profit of only $500? *Clearly, Romano's clients got better executions than Mrs. Jones even though Romano's client's paid more markup*. Why? Simply because Romano's clients paid 102 while Mrs. Jones paid 102.50. It is also important to note in this example that the length of time that transpired between customer and inter-dealer trade was irrelevant, as was the amount of the markup or *gross* profit. **This simple example shows that what is undeniably the most relevant factor is the end price to the client, as is currently reported on TRACE.**

Luckily, FINRA already has an effective method to do that in TRACE, where an investor can see the price at which bond trades were executed and compare them. However, the mere fact that investors do not look at TRACE does not mean that markup disclosure will give the public investor the necessary tools

and information they need to determine the quality of that execution. Nor does it mean that TRACE data should be abandoned in favor of "additional pricing disclosure" (read markup). As demonstrated, the only way to do so is to compare the price of their execution (which includes markup) on TRACE to the price of other timely executions (which also include markup) on TRACE. **Therefore, alternative methods for better public investor utilization of TRACE are the only answer and should be considered.**

The most obvious would be rather than to disclose only partially relevant (or totally irrelevant) markup information, would be to get better price disclosure. Clearly, price disclosure (not markups) is in the best interest of investors and we would wholeheartedly support this measure. Other comments have considered yield comparisons or "Accredited Benchmarking" to determine the "best available representation of current market price." (See DelphX comment letter, January 7 2015). Another thought is to reveal the end prices at which other trades have been executed. The problem is that while this would increase transparency, it would also be extremely costly, as this would effectively involve rebuilding a system of TRACE magnitude. Not only is the cost a concern, but questions remain in my mind as to just how better a mouse trap we would have built. For example, Bloomberg has a Fair Value estimate for many fixed income securities, but we have found this to be inconsistent with actual pricing in the market place.

It seems therefore that since price disclosure is clearly the best means for determining the quality of an execution and that information is already available in the market place through TRACE but investors aren't accessing it, then a disclosure on the confirmation outlining what TRACE is, and where to access it, and where to access instructions on how to use it would be simplest, most effective, and in order remedy. This would avoid many of the problems raised in this comment letter.

Finally and as an aside, let me address the Eder comment letter dated December 30, 2015. I disagree with his thesis that "[t]here should be full disclosure of the member firms' profit..." and "[the investing public] deserve to receive full disclosure of the member's price" as this is unprecedented. However, should this faulty and troubling proposal go into effect, and while I strongly hope it does not, I do agree that it is inconsistent to hinge this proposal on retail trades of $100,000 or less as he suggests and should affect trades of all sizes. To do otherwise would support age old conspiracies about FINRA serving large firms at the small firm's expense, and age old conspiracies about FINRA and other regulatory agencies desirous to stamp out the small firm. While I don't believe that to be the case, that narrative would only be supported by the $100,000 breakpoint, and would admittedly be suspect.

Many other comment letters have already addressed the anti-business, anti-capitalist, and anti-free market nature of this proposal. I have read in other comment letters and wholeheartedly agree, that by asking the grocer, car dealer, or gas station or any other industry other than the securities industry to reveal their gross profit is not only imponderable and wouldn't happen. What industry is next? This is deeply troubling.

Conclusion

FINRA Rule Proposal 14-52, *Pricing Disclosures in the Fixed Income Market*, is very troubling. It focuses on markup which is not the best method for determining the quality of an execution, and in many cases is irrelevant information that only obfuscates and confuses the client. In some case, it even unnecessarily alarms them. Rather, we have demonstrated that better price transparency is the most effective way for clients to measure the quality of their execution. **Rather than dismiss TRACE and abandon it since "retail clients do not typically consult" it as the proposal states and providing them with meaningless markup information that is not pertinent, the easiest solution is to use and improve price transparency through the existing TRACE system, and investor awareness of it, through well worded and visible disclosures on the confirmation.**

Sincerely,

Joseph R.V. Romano, CFP
President

Disclosure: Although I am the 2015 Chairperson of the Small Firm Advisory Board (SFAB), the views and opinions expressed herein are solely my own, and should not be construed as a formal statement from the SFAB or by corollary as the viewpoint of any other member of the board itself.

HILLIARD LYONS
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January 20, 2015

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

Mr. Ronald W. Smith, Corporate Secretary
MSRB
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: Response to the Requests for Comment from FINRA and the MSRB on Proposed Rules to Require Confirmation Disclosure of Pricing Information in Fixed Income Securities Transactions (Regulatory Notices 14-52 and 2014-20).

Dear Ms. Asquith and Mr. Smith:

Hilliard Lyons welcomes the opportunity to comment on the rule proposed by FINRA outlined in Regulatory Notice 14-52 and the MSRB outlined in Regulatory Notice 2014-20, proposing disclosure of price information on "Matched Trades" directly to customers on trade confirmations. We are a member firm of relatively small size, with 1,100 employees and approximately 400 registered representatives, which offers a unique perspective for commentary on the proposed changes. We feel very strongly that these proposals will unfairly burden small dealer firms with extremely costly revisions to fixed income trading and back office processing systems. Significant resources will be required to provide systems coding changes to both capture the suggested data comparisons and correctly communicate it on customer confirmations in real time.

Changes should be uniform in content and language across all firms. Although they will also face a burden implementing regulations of this nature, larger firms with greater IT resources will be in a position of tremendous advantage compared to small firms in this effort.

If you examine the impact of all the regulatory initiatives that have been implemented over the last year, clearly a proportionately greater burden has been placed on smaller/regional firms. This was not the intent of Dodd/Frank. Certainly the smaller firms did not precipitate the financial crises. The unexpected consequence of actions like the proposed rules is to stifle competition and lessen market liquidity.

Comments from several market regulators early in this process seemed to focus primarily on disclosure of markups for "riskless principal" trades. However, that appears to have morphed into any buy vs. sell trade comparisons under a certain par value that occur on the same CUSIP within a specified amount of time. Many proprietary positions of risk (long positions) have customer buy trades and additional firm purchase trades that follow within the same day that are unforeseen or anticipated at the original time of position purchase. Extremely high costs would be incurred by small firms to code back office systems for position accounting reporting, either at the time of trade or at the end of day to determine average cost.

To focus on "riskless principal" trades, none of this risk position accounting is necessary. Member firms should individually designate which "Matched Trades" represent actual "riskless principal" trades. We agree with SIFMA that institutional trades of any size should be exempt from the process. Retail purchases from the street with a customer order in hand would qualify, retail sells to the street with a customer order in hand would qualify, and crosses between retail customers with both sides executed together (within seconds or minutes) would qualify. None of the proprietary position examples would qualify, regardless of the trade time frame. Allow each firm to make those designations under specific regulatory guidelines, eliminating the need for computer search programs for reference trades.

We anticipate that you will shortly receive technical/operational analysis of the proposal that shows the extraordinary difficulty, in terms of time and cost, of implementing the proposals as currently drafted.

There is an alternative.

The MSRB EMMA website continues to provide the municipal market with increased transparency and has a growing audience with both member firm traders, underwriters, public finance personnel and sales people and, most importantly, municipal investors. Continued periodic enhancements could provide investors with even more detailed trade information on individual CUSIP numbers than we are discussing with the "Matched Trade" proposals. We have several suggestions as to how that information could be presented on EMMA to enhance the present disclosures:

- Color code individual trades from each dealer participating in a market for a specific CUSIP. That would greatly aid the investor in seeing how many different firms might be transacting in the market on one CUSIP. The customer could easily identify personal trades as well as any offsetting matched trades by that same dealer. At the same time, the customer could see other dealers' prices distinguished by different colors to determine if others might be offering a more favorable price. The color coding could revert to standard black type after seven days (or another time frame) to evidence older trade data.
- If member firms are required to designate "Matched Trades", a special type (italics) could be used on those two trades for instant recognition by the viewer.
- Offer a more interactive Price Discovery tool on the Trade Activity page to make it easier to compare trades on similar actively traded securities. Logic could be created to have direct links underneath the Price Discovery icon to Activity pages for specific comparable securities that meet at least 3 criteria: state, maturity, rating (either service), coupon, call features, or credit enhancement.

We feel the MSRB EMMA website is just scratching the surface of possible price/yield comparison disclosures. An informational disclosure could be required for all municipal product confirmations referencing the MSRB EMMA website address. Member firms should provide additional education information about the EMMA features on both their internal and external websites. That information could be standard language developed by an industry panel or left to each firm individually. The marketplace should leverage this useful technology instead of requiring member firms to implement very costly trade detail disclosures on each customer confirmation.

Anecdotally, we are aware of a substantial increase in the use of EMMA by our retail clients. Our guess is that this level of usage is growing exponentially and will continue to do so. Prior to spending extraordinary amounts of money and time to develop a system that may not achieve your intended goals, it makes much more sense to study EMMA's effectiveness with retail investors and put resources into expanding its reach to those investors.

Hilliard Lyons appreciates the opportunity to provide our views on the rule proposal. We would welcome any opportunity to participate in further discussions with FINRA, MSRB, and other member firms about these proposals or other marketplace issues.

Sincerely,

Alexander I. Rorke
Senior Managing Director
Municipal Securities Group

January 12th, 2015

Ronald W. Smith,
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, Virginia 22314

Financial Industry Regulation Authority (FINRA)
Los Angeles Office
300 South Grand Ave., 16th Floor
Los Angeles, CA 90071

Re: Regulatory Notice: 2014-20
Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations.

Dear Mr. Smith, et al.,

My name is Karin Tex, a retiree, and a life-time resident of California and a Citizen of the United States.

In my retirement, I have invested in municipal bonds; but I was unaware that unlike stocks, municipal bonds disclosure rules for transactions are very different. A municipal bond confirmation does not need to state the commission/mark up amount. **I know.....shocking in this day and age....especially with the evolution of sophisticated computer systems.** Disclosure of a municipal bond commission or markup to the general public should be mandatory.

According to the Municipal Securities Rulemaking Board Annual Report 2013, the Municipal Bonds Marketplace is a: $3.7 Trillion Dollar Market. There are millions of retirees, who invest in the municipal bonds, expect full disclosure and transparency in retail municipal bond transactions. Furthermore, it is my understanding that the municipal bond market generates Tens (10s) of Billions of dollars in commission per year for brokerage firms. **This should not be at the expense of retirees/seniors who have limited income.**


FINRA Los Angeles
JAN 14 2015
District Office

With such a vast municipal bond market, it is impossible for retirees/seniors to solely trust their financial advisors. A municipal bond transaction must be confirmed on a confirmation statement indicating the commission or markup amount that was charged to a retail customer. It is imperative that this is done!

It is puzzling that it has taken this long to acknowledge this deficiency in the reporting process to retail customers by the various regulatory agenciés. It is obvious according to many articles written about this problem – which has been ongoing. I am attaching herewith several articles that outline this existing problem. [Please see attached.]

Seniors/Retirees and other retail investors alike look forward to full commission/markup disclosure by municipal bond dealers. It will make the municipal bond market more honest and responsible. This will solve a huge problem.

I hope and pray that the Regulatory Powers act quickly implementing full disclosure of commissions/markups upon municipal bond dealers/brokerage firms for the benefit of all retail customers.

Best regards,
Karin M. Tex
Karin Tex

KT/cs
Encl:

Service List

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   Michele Wein Layne, Regional Director
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4. Rep. Susan Davis – U.S. 53rd District
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5. San Diego Union Tribune
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Muni-bond purchase fees sting retirees

By Glenn Ruffenach

In what may turn out to be a boon for the many retirees who rely on them for income, yields on municipal bonds are increasing. But investors thinking about jumping in the muni pool need to recognize that the "markup" on some products can be much larger – and more painful – than they realize.

A slowly improving economy is translating into healthier municipalities across the country – and relatively attractive returns for those municipalities' tax-free bonds. Yields on the highest-quality, most widely traded munis – triple-A-rated, 10-year "general obligation" bonds – have risen by 0.45 percentage point since May 1, according to Daniel Berger, senior market strategist at Municipal Market Data.

But as Jason Zweig reported recently in The Wall Street Journal, investors who rush out to buy munis could unknowingly hand over their first year's worth of income to their broker.

The problem: excessive markups. A markup is the difference between a broker's cost and the price an investor pays for a bond. Many brokers don't disclose that figure – and many investors don't ask about it. And that's a recipe for disaster.

Securities Litigation and Consulting Group, a research firm in Fairfax, Va., recently analyzed nearly 14 million trades of long-term, fixed-rate munis over a period between 2005 and April of this year. On one out of 20 trades, individuals who bought $250,000 or less in municipal bonds paid a markup of at least 3.04% — or approximately a full year's worth of interest income at today's rates.

By comparison, a typical mutual fund charges management fees of about 1% a year, and most online brokers charge $10 to buy a stock – which would amount to 0.004% on a $250,000 purchase.

What to do? Start with "Emma." That's the acronym for a website – Electronic Municipal Market Access – maintained by the Municipal Securities Rulemaking Board, a regulatory body that oversees the muni market. Here, you can see what customers are paying for bonds. (The site identifies trades, but not the names involved.) Then, use that information to negotiate the best price possible from your broker.

No, you won't always get the markup you think is fair. But at least you'll be dealing from a stronger position. As Phil Potter, an electrical engineer who lives in the Los Angeles area and regularly negotiates bond purchases, told Zweig: "Just because the yield sounds good doesn't mean you aren't overpaying."

8-25-2010

If you own bonds, you could be getting ripped off

From Bloomberg:

Peter Kuhn, an investor from San Jose, California, who owns more than $1 million in municipal bonds, scours pricing websites and uses Zions Bancorporation's online brokerage to avoid getting overcharged when he buys tax- exempt debt.

Consumers who aren't as savvy may be paying more than they have to for state and local obligations in the $2.8 trillion U.S. municipal market, where individuals and mutual funds hold about two-thirds of outstanding securities. Firms selling to customers mark up the price an average $5 to $10 per $1,000 bond, or 0.50 percent to 1 percent, said Thomas Doe, chief executive officer of Municipal Market Advisors, a Concord, Massachusetts-based research firm.

Because tax-free yields are at their lowest levels in four decades and dealers have flexibility on pricing, investors have to be more careful to make sure the markup they're being charged isn't excessive, said Mitchel Schlesinger, chief investment officer at FBB Capital Partners.

"Do more homework to make sure you're not getting ripped off," said Schlesinger, who oversees $80 million in munis for the Bethesda, Maryland-based advisory firm. "You could easily give up a year of coupon income because yields are so low."

Shrinking supplies of tax-free municipal debt and the lowest rates on U.S. Treasury 10-year notes in more than a year have driven down yields on 10-year and 30-year AAA general obligation bonds to the lowest levels since the 1960s.

according to MMA's Doe. The 10-year tax-exempt rate was 2.60 percent as of Aug. 24 and the 30-year rate was 4.16 percent, according to MMA's indexes.

Broker Compensation

About 2,000 firms from Bank of America Corp.'s Merrill Lynch to New York-based Lebenthal & Co. buy and sell state and local securities to individuals, according to the Municipal Securities Rulemaking Board in Alexandria, Virginia. The obligations aren't traded on exchanges like stocks. Dealers typically are compensated in lieu of a commission by marking up a bond's price when selling to customers or marking down when buying, said Ernesto Lanza, general counsel for the MSRB, which sets rules for the industry.

'Fair and Reasonable'

That's legal as long as the markup or markdown is "fair and reasonable," according to the MSRB. Brokers consider items including market value, transaction costs, trade size, credit quality and risk involved in owning the bond when deciding the total price charged to the customer, Lanza said.

Investors can use EMMA, the MSRB's Electronic Municipal Market Access website, to type in a bond's serial number, known as a Cusip, and see how a broker's offering lines up with what other consumers paid. For example, on Aug. 9 a New York City general obligation bond maturing in 2019 traded four times in two hours, according to EMMA. A dealer bought from another firm $35,000 in bonds priced at 110.79 cents on the dollar. The same- size lot was sold to an investor priced at 112.01 and yielding 1.85 percent.

That differential in price eats up almost a year's worth of income, said Schlesinger.

Another customer buying an $800,000 lot of the bond the same day received a price of 110.51 for a 2.22 percent yield, according to MSRB data.

"It pays to be a savvy investor," said Bhu Srinivasan, publisher of the research website municipalbonds.com. "If you ask, or you have a relationship with a broker where they know you are an aggressive shopper, you may get a better price."

Municipal bonds are generally exempt from federal taxes as well as state and local levies for residents in most states where they're issued. For highest earners paying a 35 percent federal rate on income, a 2.60 percent return on the securities is equivalent to a 4 percent taxable yield.

'Best Value'

Kuhn, the California investor, looks up recent trades before buying because "you want the best value for your dollar," he said.

The 49-year-old founder of an employee benefits consulting firm said he purchases munis on zionsdirect.com. The Salt Lake City-based online brokerage charges $10.95 per online trade and doesn't mark up securities over the price it paid, said Veronica Atkinson, vice president of bond trading for Zions Direct.

"Recent price information isn't always available to investors because the industry includes many small issuers whose bonds may not trade often," said Guy LeBas, chief fixed-income strategist for Janney Montgomery Scott LLC in Philadelphia with $7.3 billion in tax-free bond assets.

Similar Securities

Almost all trades of new municipal issues in the secondary market occur within the first 30 days. That's why investors selling bonds also should watch their pricing because no one may have bought them in more than a year, said Srinivasan.

Consumers can view securities of similar maturity and credit quality on sites such as EMMA if there's no recent data on the obligation they're searching for, said Michael Decker, co-head of the municipal securities division at the Securities Industry and Financial Markets Association, a trade group based in New York and Washington.

Investors can avoid the varying markups on munis trading in the secondary market by buying new issues during a so-called retail order period when one is offered.

The state of California typically has two days when people can place orders ahead of firms in some debt sales. Consumers and institutions receive the same final price, and individuals may cancel their orders if they don't like the final cost, said Tom Dresslar, spokesman for California Treasurer Bill Lockyer.

No-Markup Buying

Investors placed early orders for 55 percent of issues sold during California's $2.5 billion tax-exempt bond sale in March, Dresslar said. While individuals still have to go through a broker, there's no markup, according to the state's Buy California Bonds website. Instead, sellers receive a portion of the income derived from the sale of the securities, Dresslar said.

The definition of what's "fair and reasonable" for markups charged to investors buying in the secondary market has led to complaints brought by individuals and actions by regulators against firms. The Financial Industry Regulatory Authority accepted settlements this year with RBC Capital Markets Corp., a New York-based broker-dealer, and Los Angeles- based Wedbush Securities Inc. Finra, based in Washington, is a non-governmental body overseeing almost 5,000 brokerage firms.

Lawsuit Settled

Both firms resolved the regulatory actions without admitting or denying Finra's findings, including that RBC unfairly priced six municipal debt transactions in 2007 and Wedbush, five transactions in 2008.

Natalie Taylor, a spokeswoman for Wedbush, and RBC spokesman Kevin Foster both declined to comment in e-mails.

Investors Gene and Patricia Boyce of Raleigh, North Carolina, settled their class-action lawsuit in June with Wachovia Securities LLC, acquired in 2008 by San Francisco-based Wells Fargo & Co., according to court documents.

The complaint said Wachovia offered the Boyces bonds marked up two to almost five times the 50 basis points agreed on. A basis point is 0.01 percentage point.

Wells Fargo declined to comment, spokeswoman Teresa Dougherty said in an e-mail.

Gene Boyce said in a telephone interview that he couldn't discuss the resolution of the case.

"There's a lot of people like me investing because it's tax-free, it's a fairly safe and stable market and you're virtually guaranteed the coupon rate," said Boyce, a lawyer.

Munis tend to attract even more investors when taxes are rising, said John Hallacy, a municipal strategist in New York for Bank of America Merrill Lynch. In 2011, federal income tax rates for the highest earners will go to 39.6 percent from 35 percent, unless Congress acts.

Dwindling Supply

The supply of tax-exempt munis has shrunk since Congress established the Build America Bond program last year, giving subsidies to state and local governments issuing taxable debt. Total new issues of tax-exempt debt in the 12 months through July 2010 was $304 billion, down 30 percent from the same period through July 2008, according to MMA's Doe.

Investors who can't buy bonds in lots worth $25,000 or more should consider funds for diversity and because smaller issues tend to have larger markups, Janney's LeBas said.

The average expense ratio for a no-load municipal bond fund, or one that doesn't have an upfront charge, is 0.60 percent, said Miriam Sjoblom, a bond-fund analyst for Morningstar Inc., a Chicago-based research firm.

"When bonds trade, the price isn't dictated by an omniscient source," said Josh Gonze, who helps manage $6 billion in municipal bond funds and accounts for Thornburg Investment Management Inc. in Santa Fe, New Mexico.

With yields so low, investors purchasing individual bonds should know how markups work because they'll "take a relatively bigger chunk from the investor's total return," he said.

To contact the reporter on this story: Margaret Collins in New York at mcollins45@bloomberg.net.

MSRB
Municipal Securities Rulemaking Board

Regulatory Notice

2014-20

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Stakeholders
Municipal Securities Dealers, Municipal Advisors, Investors, General Public

Notice Type
Request for Comment

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January 20, 2015

Category
Uniform Practice

Affected Rules
Rule G-15

Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations

Overview

The Municipal Securities Rulemaking Board ("MSRB") is seeking comment on draft rule amendments to require a broker, dealer, or municipal securities dealer ("dealer") to disclose additional information on customer confirmations for transactions in municipal securities. Specifically, the MSRB is proposing that, for same-day, retail-size principal transactions, dealers disclose on the customer confirmation the price to the dealer in a "reference transaction" and the differential between the price to the customer and the price to the dealer. This potential disclosure, made in connection with the investor's transaction, may be significantly beneficial for purposes of the investor's understanding of the market for the traded security. The MSRB and the Financial Industry Regulatory Authority ("FINRA") have been engaged in ongoing dialogue in furtherance of a coordinated approach to potential rulemaking in this area. FINRA is also publishing a notice soliciting comment on a similar proposal that would apply to other areas of the fixed income market.[1] The MSRB is seeking comment as to all elements of its proposal, including the scope of pricing information that should be disclosed, the transactions for which such disclosures should be made, and the likely benefits and economic consequences of such a requirement for investors and dealers, including the likely costs and burdens. Specific comment is also sought as to alternatives that could similarly increase price transparency, particularly for retail customers.

Comments should be submitted no later than January 20, 2015, and may be submitted in electronic or paper form. Comments may be submitted electronically by clicking here. Comments submitted in paper form should

[1] *See* FINRA Regulatory Notice 14-52 (Nov. 2014) ("FINRA Proposal").

be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314. All comments will be available for public inspection on the MSRB's website.[2]

Questions about this notice should be directed to Michael L. Post, Deputy General Counsel, or Saliha Olgun, Counsel, at 703-797-6600.

Background

The MSRB is charged by Congress to protect investors and foster a free and open municipal securities market.[3] Under this mandate, the MSRB has advanced many initiatives to create and enhance MSRB products and rules with the goal of improving transparency, efficiency and other structural aspects of the market.[4]

First effective in 1978 and most recently amended in 2014, the MSRB's fair-pricing standards are a cornerstone of the municipal securities market.[5] MSRB Rule G-30, on prices and commissions, applies to dealer principal and agency transactions in municipal securities. Generally, it provides that dealers acting in a principal capacity may only purchase municipal securities from or sell municipal securities to a customer at an aggregate price (including any markup or markdown, collectively "markup") that is fair and reasonable. Similarly, when acting in an agency capacity, dealers may only

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[2] Comments are posted on the MSRB website without change. Personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.

[3] Securities and Exchange Act of 1934 § 15B(b)(2)(C), 15 U.S.C. 78o-4(b)(2)(C).

[4] *See* MSRB Long-Range Plan for Market Transparency Products (Jan. 27, 2012). The MSRB has requested comment and is analyzing information from market participants on potential improvements to the timeliness, fairness and efficiency of price transparency in the municipal market. *See* Concept Release on Pre-Trade and Post-Trade Pricing Data Dissemination through a New Central Transparency Platform, MSRB Notice 2013-14 (Jul. 31, 2013); Request for Comment on More Contemporaneous Trade Price Information Through a New Central Transparency Platform, MSRB Notice 2013-02 (Jan. 17, 2013). *See also* U.S. Securities and Exchange Commission, Report on the Municipal Securities Market, at pp. 117, 141 (Jul. 31, 2012) ("SEC Report") (noting MSRB transparency initiatives).

[5] Effective July 7, 2014, Rule G-18, on execution of transactions, and Rule G-30, on prices and commissions, were consolidated into a single rule under amended Rule G-30. *See* MSRB to Consolidate Dealers' Fair-Pricing Obligations into MSRB Rule G-30, MSRB Notice 2014-11 (May 12, 2014).

purchase or sell municipal securities for a commission or service charge that is fair and reasonable. Further, Rule G-30 requires dealers to exercise diligence in establishing the market value of the securities and the reasonableness of their compensation. FINRA Rule 2121, on fair prices and commissions, sets forth an analogous, although not identical, standard applicable to equity securities and certain debt securities, including corporate bonds.

While Rule G-30 requires that prices with respect to municipal securities transactions with customers be fair and reasonable, it does not require the disclosure of dealer compensation and/or transaction costs that are often factored into customer prices. For many securities other than municipal securities, the disclosure of such information is required on a customer confirmation under Securities and Exchange Commission ("SEC") Rule 10b-10. For example, the rule generally requires broker-dealers, when acting in an agency capacity, to disclose the amount of any remuneration received from the customer in connection with the transaction.[6] Additionally, the provisions of Rule 10b-10 that require a broker-dealer to disclose the amount of its markup do not apply to municipal securities, or for that matter to any fixed income securities.

In the municipal market, MSRB Rule G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers, requires the dealer to disclose on the confirmation the price of a municipal securities transaction. With respect to agency transactions, the dealer must also disclose on the confirmation the amount of remuneration received from the customer in connection with the transaction. If the dealer is acting as principal, however, there is no requirement that the dealer disclose its markup on the confirmation. Similarly, in the corporate bond market, broker-dealers executing agency transactions must generally disclose the amount of remuneration,[7] but are not required to disclose the amount of any markup.

Since the 1970s, the SEC has undertaken efforts to improve price transparency and reduce transaction costs in the municipal securities and corporate bond markets, prompting several SEC rulemaking efforts. In 1976,

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[6] *See* Rule 10b-10(a)(2)(i).

[7] *See id.* and accompanying text. FINRA Rule 2232 on customer confirmations requires, in relevant part, a broker-dealer to send to a customer a confirmation of the transaction in accordance with SEC Rule 10b-10.

the SEC proposed to require markup disclosure by non-market makers in riskless principal transactions involving both equity and debt securities. This was followed by a 1977 proposal to require markup disclosure by non-market makers in riskless principal transactions involving equity and debt securities, but not municipal securities. In 1978, the SEC proposed to require markup disclosure for riskless principal trades in municipal securities. More recently, in 1994, the SEC again proposed to require confirmation disclosure of markups for riskless principal transactions in municipal securities.

These markup disclosure proposals were met with significant resistance. Commenter concerns focused primarily on: the potential negative effects of such disclosure on competition and market liquidity; possible compliance difficulties, including concerns about identifying the intended "riskless" principal transactions; the potential for customer confusion; and whether there was a need for such disclosures.[8]

In 2012, the SEC issued the Report on the Municipal Securities Market in which it broadly examined the market, including regulatory structure, market structure and market practices.[9] A common theme in the report was concern about transparency and pricing for customers, particularly retail customers. The report noted that, while the compensation on a municipal securities agency transaction must be disclosed as a commission, the compensation or markup on a principal transaction is not required to be disclosed.[10] It also noted that retail customers typically have access to substantially less pricing information than other market participants.[11] Without such information, investors may find it difficult to evaluate the fairness of the pricing of their securities or the costs associated with their transactions.

To address these concerns, the SEC recommended, among other things, that the MSRB consider: requiring dealers to disclose to customers, on confirmations for riskless principal transactions, the amount of any markup; encouraging or requiring dealers to provide retail customers relevant pricing reference information with respect to a municipal securities transaction effected by the dealer for the customer; and requiring dealers to seek the

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[8] *See e.g.* Securities Exchange Act Release No. 34962 (Nov. 10, 1994), 59 FR 59612, 59615 (Nov. 17, 1994) ("1994 Release").

[9] *See* SEC Report.

[10] SEC Report at 147.

[11] SEC Report at 147.

best-execution of customer orders. In 2014, the MSRB announced that it was developing a 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 further stated that the proposal would broadly seek input on alternative regulatory approaches, including markup disclosure on confirmations for trades that could be considered riskless principal transactions.[12]

Significant advances in the fixed income markets have helped to improve price transparency since the SEC's previous rulemaking efforts. Indeed, the SEC deferred consideration of its 1994 markup disclosure proposal due, in large part, to the planned development of systems that would make publicly available pricing information for municipal securities transactions. The SEC noted that the industry's efforts to improve transparency would result in enhanced price transparency for a broader number of transactions in the debt markets than the 1994 rule proposal would have affected.[13]

Launched in 2009, the MSRB's Electronic Municipal Market Access ("EMMA®") website is the municipal market's official free source of data and information on municipal securities. Through the EMMA website, market participants may access official disclosure documents, trade prices and yields, market statistics and more about virtually all municipal securities. MSRB Rule G-14, on reports of sales or purchases, currently requires dealers to report all executed transactions in municipal securities to the MSRB's Real-time Transaction Reporting System ("RTRS") within fifteen minutes of the time of trade, with limited exceptions. The RTRS system has been operational since 2005.[14] Since the launch of RTRS and EMMA, the MSRB has continually sought to improve price transparency in the municipal market through

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[12] *See* MSRB Holds Quarterly Meeting, Press Release (May 6, 2014); MSRB Holds Quarterly Meeting, Press Release (Aug. 5, 2014); MSRB Holds Quarterly Meeting, Press Release (Nov. 3, 2014). In the May press release, the MSRB also announced that it would seek SEC approval to implement a best-execution standard for transactions in the municipal securities market. The MSRB sought such approval on August 20, 2014. *See* Securities Exchange Act Release No. 72956 (Sept. 2, 2014), 79 FR 53236 (Sept. 8, 2014), File No. SR-MSRB-2014-07 (Aug. 20, 2014).

[13] *See* 1994 Release at 59612.

[14] In 2009, the MSRB additionally established the Short-Term Obligation Rate Transparency ("SHORT") system to collect and disseminate current interest rates and related information for auction rate securities and variable rate demand obligations.

enhancements to these systems.[15] In 2014, for example, the MSRB launched a new Price Discovery Tool on EMMA that permits market participants to more easily find and compare trade prices of municipal securities with similar characteristics.

Advances have also been made in other areas of the fixed income markets. In 2002, FINRA launched the Trade Reporting and Compliance Engine ("TRACE®") to improve post-trade price transparency in the corporate bond market. TRACE is the over-the-counter real-time transaction reporting and dissemination service for transactions in eligible fixed income securities.[16] Similar to the reporting time applicable to the MSRB's RTRS, transactions in eligible fixed income securities must be reported to TRACE generally within fifteen minutes of the time of execution. This transaction information is immediately disseminated for all securities subject to dissemination.[17]

With the use of information disseminated through these platforms, investors can make a more informed evaluation of the price paid or received for their fixed income securities. But because there is currently no markup disclosure requirement for fixed income securities, including municipal securities, dealers do not generally report their markups and such information is not disseminated to the market through EMMA or TRACE. Investors may, however, use EMMA and TRACE view recent trade prices in the same or similar securities in similar quantities to compare trade prices.

Additionally, by viewing this trade data, in some cases, an investor may determine dealer acquisition cost and the investor's transaction costs for the securities. For example, if the reported trade data on EMMA showed that only moments before an investor purchased a quantity of securities, a dealer purchase was made for the same quantity of the same securities, the

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[15] *See supra* n. 4 and accompanying text. On July 15, 2014, the MSRB published a report on municipal market trading patterns, associated pricing and the effect of price transparency on pricing. The report provides a baseline set of statistics about municipal bond trading to enable market stakeholders and the MSRB to make further advancements with respect to the fairness, efficiency and transparency of the municipal market.

[16] TRACE eligible securities generally include debt securities denominated in USD and issued by a US or foreign private issuer and with a maturity of greater than one year. Eligible securities include corporate debt, agency debentures, and asset and mortgage backed securities.

[17] The securities subject to dissemination by TRACE currently include publicly traded and 144A corporate debt securities, agency debentures, agency pass through mortgage backed securities traded TBA and in specified pool transactions and, as of April 2015, asset-back securities.

investor could reasonably infer that the prior trade involved his or her dealer. The investor could further infer that the differential between those trade prices accounted for the investor's transaction costs. The table below illustrates this example. While this differential is not necessarily the same as a markup,[18] it can provide the investor increased price transparency and significant insight into the market for the security. An analysis of this differential may also achieve many of the regulatory objectives of a markup disclosure requirement.

Table 1

Trade Date/Time	Settlement Date	Price (%)	Yield (%)	Trade Amount ($)	Trade Type
11/5/2014 3:30 PM	11/13/2014	100.975	3.882	25,000	Customer bought
11/5/2014 3:29 PM	11/13/2014	98.996	4.058	25,000	Inter-dealer trade

While these advances have generally helped to make pricing information more accessible to the market, such information still is generally directly beneficial only to those who actively seek it out. The disclosure of such information on a retail customer's confirmation would provide additional transparency even to those investors who do not actively seek out the information, including those who may not know of EMMA or may not have the time or wherewithal to conduct their own transaction research.

The MSRB, FINRA and the SEC are engaged in ongoing dialogue in furtherance of a coordinated approach to this topic.[19] If the MSRB and FINRA determine that rulemaking is warranted, the MSRB and FINRA plan to

[18] A markup is commonly considered to be the differential between the prevailing market price of a security at the time the dealer sells the security to the customer and the higher price paid by the customer to the dealer. Similarly, a markdown is commonly considered to be the differential between the prevailing market price of a security at the time the dealer purchases the security from the customer and the lower price paid to the customer by the dealer. *See* Municipal Securities Rulemaking Board, MSRB Glossary.

[19] In a June 20, 2014 speech, SEC Chair Mary Jo White announced support for additional disclosures to help investors better understand the costs of their fixed income transactions. *See Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors,* Economic Club of New York, New York, NY, available at http://www.sec.gov/News/Speech/Detail/Speech/1370542122012. With input from SEC staff, the MSRB and FINRA have developed complementary proposals for their respective markets and will continue to pursue a coordinated approach to this issue.

institute coordinated requirements to the extent possible and appropriate in light of the differences in the municipal securities market and other areas of the fixed income markets. Among other things, this approach should assist in mitigating the potential compliance burden on dually registered dealers.

Request for Comment

A pricing reference information disclosure requirement could be a logical next step in the MSRB's efforts to improve price transparency in the municipal securities market, and could effectively complement any future best-execution rule.

The goal of the proposed disclosures is ultimately to better inform retail investors. With relevant pricing reference information, received in the context of their securities transactions, retail investors could gain valuable insight into the market for the securities they trade. They may also more easily evaluate their transaction costs and the fairness of the price they paid or received for the securities. Additionally, knowledge on the part of dealers that such pricing information will be provided to investors may help to ensure that prices and markups are appropriate in light of the market for the security.

Pricing Reference Information Disclosures

Under the draft amendments, a new provision would be added to Rule G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers. This provision would require a dealer to disclose on the customer confirmation its trade price for a defined "reference transaction" as well as the difference in price between the reference transaction and the customer trade. A reference transaction generally is one in which the dealer, as principal, purchases or sells the same security that is the subject of the confirmation on the same date as the customer trade. The disclosure requirement would be triggered only where the dealer is on the same side of the transaction as the customer (as purchaser or seller) and the size of such dealer transaction(s), in total, would equal or exceed the size of the customer transaction. Accordingly, for a customer sale of municipal securities to the dealer, the dealer would be required to disclose pricing information for same-day reference transactions in which the dealer sold the securities in a principal capacity. Similarly, for a customer purchase of municipal securities from the dealer, the dealer would be required to disclose pricing information for same-day reference transactions in which it purchased the securities in a principal capacity.

The proposal would require dealers to calculate and disclose the difference in price between a reference transaction disclosed on the confirmation and

the price to the customer receiving the confirmation. Thus, for example, if a dealer purchases 50 bonds in XYZ securities at a price of 100 for $50,000 and, on the same day, sells 50 bonds in those same securities to a customer at a price of 102 for $51,000, the dealer would be required to disclose on the customer's confirmation both the price of the reference transaction (100), which is currently available to the customer on EMMA, as well as the differential between the price of each trade (2).[20]

Applying the example from Table 1 above, the dealer would be required to disclose the reference transaction price of 98.996, which again is currently available to the customer on EMMA, as well as the price differential of 1.979 (calculated by subtracting the reference transaction price of 98.996 from the customer transaction price of 100.975).

An alternative approach would be to require dealers to disclose the total dollar amount differential between the reference transaction and the customer transaction.[21] If such an approach were pursued, in the same example above, the dealer would be required to disclose a total dollar amount differential of $1,000 (2% of $50,000 par amount). This approach could be pursued either in lieu of or in addition to the disclosure of the price differential as currently contemplated in the proposal. The MSRB seeks comment as to the type of pricing information dealers should be required to disclose on the customer confirmation. Are any or all of the options discussed optimal for providing customers the information that would be the most helpful to them? Are there better alternatives or equally effective alternatives that would impose fewer costs or burdens on dealers?

Retail Customers

Because a goal of the proposed disclosures is to provide relevant and helpful pricing information to retail investors in particular, the proposal would require a dealer to make pricing reference information disclosures only where the transaction with the customer is a retail-size transaction. The proposal categorizes a transaction involving 100 bonds or fewer or bonds in a par amount of $100,000 or less as a retail-size transaction. However, this

[20] The price of a transaction is an expression of percentage of the principal amount of the securities. The price differential would reflect the difference in percentages of principal between the acquisition cost and transaction cost. Multiplying the price differential by the par amount transacted would provide the dollar amount difference between the acquisition cost and transaction cost. A price differential of 2 means 2% of the par amount (2% of $50,000 or .02 x $50,000).

[21] *See* n. 20.

approach may not necessarily capture every retail trade and may, in some instances, capture some small trades executed on behalf of an institutional customer. An alternative approach would be to require the disclosures to be made to customers that are not sophisticated municipal market professionals or SMMPs as defined in MSRB Rule D-15. The MSRB specifically requests comment as to whether these approaches or a different approach would best serve the goals of the proposal. The MSRB is interested in input, in particular, regarding whether dealers would prefer to make the proposed disclosures to all customers, rather than a subset of customers likely to be retail investors. Specifically, to the extent that the proposal would require dealers to reprogram their systems for generating confirmations to determine when the disclosures would be made, would disclosing pricing reference information to all customers mitigate the compliance burden for dealers?

Same-day Period

The proposal would require a reference transaction price to be disclosed on the customer confirmation when the reference transaction is executed on the same trade date as the customer transaction. A review of EMMA trade data suggests that a significant percentage of retail-size trades have an offsetting trade in exactly the same quantity or similarly sized quantities within a short time from the customer trade. The number of these trades increases when this time period is lengthened to capture trades executed on the same date.[22] The MSRB believes that the disclosure of pricing reference information for trades in the same security in which the dealer acted on the same side of the transaction as the customer can provide helpful pricing information to investors. However, the MSRB recognizes that as the time period between trades increases, the degree to which the price of the reference transaction will be helpful to the customer may decrease.

An alternative to the same-day standard would be to limit the universe of trades for which pricing information must be disclosed to those trades that occur within a shorter or longer time range from the customer trade (*e.g.*, within thirty minutes of the customer trade or within two days of the customer trade). However, a shorter time period would likely result in fewer pricing reference disclosures to customers and may incentivize some dealers to time the execution of a trade so as not to trigger the disclosure

[22] Trade data from EMMA shows that approximately 21.32% of retail-size trades conducted during the twelve-month period of June 2013 through June 2014 had an offsetting trade transacted by the same dealer in the same size as the customer trade and on the same trade date as the customer trade (excluding new issue trades, which for purposes of this analysis were deemed to be any trade within fifteen days of the offering sale date).

requirement. The MSRB seeks comment as to the appropriate time relation between trades for the purposes of the proposed pricing disclosures.

Reference Transaction Size

Under the proposal, pricing reference information must be disclosed for reference transaction(s) that, in total, equal or exceed the size of the customer transaction. Thus, a dealer would be required to disclose pricing information for a single trade that equals or exceeds the size of the customer trade. Additionally, a dealer would be required to disclose such information for a trade that, when combined with one or more other same-day reference transactions, equals or exceeds the size of the customer trade.

When multiple dealer trades equal or exceed the amount of the customer trade, many methodologies may be available to a dealer to determine which price to disclose on the customer confirmation. These may 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 (LIFO) methodology); or disclosing the weighted average price of multiple trades. The MSRB seeks comment as to the appropriate standard(s) to apply under the proposal, as well as the situations in which such standards should be used. The MSRB also requests comment as to the costs and burdens as well as programming issues surrounding the use of one or more of these or any alternate methodologies for determining the appropriate pricing information to disclose. The MSRB specifically seeks comment on the methodologies that should be applied in the municipal securities market in examples 7, 9 and 10 in the FINRA Proposal.

The proposal assumes that one or more transactions that, in total, equal or exceed the size of the customer transaction are sufficiently similar to the customer trade or may form the basis from which a dealer may fill a customer order on the same day, such that the disclosure of pricing information for these transactions may be beneficial to the customer. Notably, because the proposal would apply to customer trades for 100 bonds or fewer or bonds in a par amount of $100,000 or less, the disclosure requirement should not have a significant impact on the institutional market for municipal securities.

Alternate size parameters might be equally or better suited to provide customers with relevant pricing information. One alternative might be to limit the disclosure of pricing information to only trade sizes that are identical to the customer's trade size. However, such a standard would result in less pricing information disclosed to the customer and may incentivize some dealers to modify trade sizes. Another alternative would be to require the dealer to disclose pricing information for its transactions in the same

securities on the same trade date if the trade sizes are within a specified range that is either smaller or larger than the customer's transaction (*e.g.* 50% smaller and 100% larger). These approaches would likely result in the disclosure of pricing reference information to fewer customers, but may result in disclosures that are more pertinent to a customer when they are made. As discussed below, the MSRB invites comment as to the proper parameters for reference transaction sizes for which pricing information should be required to be disclosed on the customer confirmation.

Explanatory Notations

To help ensure that the proposed pricing reference disclosures are meaningful to customers, dealers may wish to provide explanations or descriptions, in plain language, to assist customers in understanding the disclosures. For example, such descriptions might explain that the disclosed pricing information is expressed as a percentage and might further provide brief explanation as to how the price differential was calculated. Such explanations may also be utilized to provide some context for customer interpretation and analysis of the prices, which may be particularly helpful in the event of intra-day market events or other circumstances that might at least partially explain price differentials. Explanations and descriptions, if not included on the confirmation, could be provided in materials accompanying the delivery of the confirmation. The MSRB specifically invites comment as to these aspects of the proposal.

Economic Analysis

The MSRB has historically given careful consideration to the costs and benefits of its new and amended rules. The MSRB's policy on the use of economic analysis in rulemaking states that prior to proceeding with a rulemaking, the Board should evaluate the need for the rule and determine whether the rule as drafted will, in its judgment, meet that need. During the same timeframe, the Board also should identify the data and other information it would need in order to make an informed judgment about the potential economic consequences of the rule, make a preliminary identification of both relevant baselines and reasonable alternatives to the proposed rule, and consider the potential benefits and costs of the draft rule and the main alternative regulatory approaches.

1. **The need for the proposed rule and how the proposed rule will meet that need.**

The need for the proposed rule arises from the MSRB's regulatory obligations under the Exchange Act to protect investors and foster a free and open market in municipal securities.[23] Ensuring that customer transactions are effected at a fair and reasonable price[24] and making meaningful and useful information about transactions publicly available are two important ways in which the MSRB meets this mandate.

This rule builds on previous MSRB initiatives and addresses an ongoing concern that because retail municipal securities investors have access to less pricing information than other market participants, have a more limited ability to identify the most relevant pricing information, and may encounter significant burdens associated with access and acquisition of relevant information, they may not be able to effectively evaluate the market for their securities or the transaction costs associated with their securities.[25]

Currently, retail customers may use EMMA to gain insight into the market for the securities they trade by viewing recent trade prices in the same or similar securities in similar quantities. However, using EMMA to conduct the relevant pricing analysis requires that customers actively seek out information and make inferences as to which transactions are most relevant. Conducting this type of pricing analysis places a burden on retail customers.

The proposal also addresses the lack of a consistent standard for disclosure of pricing information via customer confirmations for similar types of securities transactions. The SEC has addressed this issue for certain equity securities in Rule 10b-10 and FINRA is proposing similar disclosures for its members engaged in transactions of non-municipal security fixed income securities.

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[23] Securities and Exchange Act of 1934 § 15B(b)(2)(C), 15 U.S.C. 78o-4(b)(2)(C).

[24] *See* MSRB Rule G-30, on prices and commissions.

[25] *See generally* SEC Report.

2. **Relevant baselines against which the likely economic impact of elements of the proposed rule can be measured.**

To evaluate the potential impact of the proposed rule, a baseline, or baselines, must be established as a point of reference. The analysis proceeds by comparing the expected state with the proposed rule in effect to the baseline state prior to the proposed rule taking effect. The economic impact of the proposed rule is measured as the difference between these two states.

Three existing MSRB rules serve as relevant baselines: Rules G-14, on reports of sales or purchases, G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers, and G-30, on prices and commissions. Proposed revisions to Rule G-18 that would establish a best-execution obligation on dealers may also be a relevant baseline.

Rule G-14 requires dealers to report all executed transactions in municipal securities to RTRS within fifteen minutes of the time of trade, with limited exceptions. This information is made public through EMMA. The proposal would require dealers to identify which of its transactions reported to RTRS will serve as a reference transaction, and to disclose both the price of a reference transaction and the difference in price between a reference transaction and the customer trade. The disclosures would only be required for transactions in which the dealer is a party on the same side of the transaction as the customer.

Rule G-15 requires, among other things, dealers to disclose on the confirmation the price of a municipal securities transaction. With respect to agency transactions, the dealer must also disclose on the confirmation the amount of remuneration received from the customer in connection with the transaction.

Rule G-30 provides that dealers acting in a principal capacity may only purchase municipal securities from, or sell municipal securities, to a customer at an aggregate price that is fair and reasonable and requires that dealers exercise diligence in establishing the market value of the securities and the reasonableness of their compensation.

3. **Identifying and evaluating reasonable alternative regulatory approaches.**

The MSRB recognizes that there are alternatives to the proposed approach that range from taking no action, providing additional information via EMMA,

requiring dealers to disclose information on the customer confirmation other than what is proposed above (including disclosure of markups on riskless principal transactions), requiring disclosure of pricing reference information under alternative parameters, or some combination thereof.

The MSRB could take no action. Under this alternative, retail customers would continue to use EMMA to acquire market information and evaluate the costs associated with their transactions. Retail customers would not be able to ascertain with certainty the specific price paid by its dealer and may, therefore, be relying on less useful information. To address this, the MSRB could develop an internal methodology for identifying a reference transaction and provide this information to the public. The MSRB seeks comments that would help to quantify the existing burdens of accessing market information via EMMA and the degree to which changes to what is currently provided to the public would mitigate or increase these burdens.

The MSRB could require dealers to disclose information other than the price of a reference transaction and the difference in price between a reference transaction and the customer trade. For example, the MSRB could require disclosure of only the price of a reference transaction and not require disclosure of the price differential or the MSRB could require disclosure of the total trade price differential between a reference transaction and the customer transaction in lieu of or in addition to the disclosure of the price differential as proposed.

The MSRB could also require the inclusion of other market information (*e.g.*, prices provided by external pricing services) on the confirmation. The MSRB seeks comments on whether any of these alternatives provide customers with more meaningful and useful information, whether that value of additional information can be quantified, and the degree to which any of these alternatives would be more or less costly to implement.

The MSRB could specify a shorter or longer period during which a reference transaction may take place. For example, an alternative to the same-day threshold could be to limit the disclosure requirement for those principal trades that occur within thirty minutes of the customer trade or extend the time period to beyond one day. The MSRB seeks comments that would support quantification of the relevance of transactions that occur more or less closely in time to the customer transaction and the degree to which a change in the threshold would increase or decrease costs associated with disclosure.

The MSRB could specify an alternative definition of the size that a dealer transaction must be to meet the definition of a reference transaction. For

example, the MSRB could specify that reference transactions are only those dealer transactions that are identical in size to the customer transaction or meet an alternative definition of "similar size" (*e.g.*, 50 percent smaller or 100 percent larger than the customer transaction). The MSRB seeks comments that would support the quantitative evaluation of the degree to which transactions need to be similarly sized to provide meaningful and useful market information and the degree to which a change in the size definition of a reference transaction would increase or decrease costs associated with disclosure.

The MSRB could specify the methodology by which a reference transaction price is determined when the size of a reference transaction is not identical to the size of the customer transaction. As noted above, the FINRA Proposal identifies methodologies for calculating a reference price under a range of scenarios. The MSRB seeks comment on the degree to which particular methodologies are more or less likely to result in a disclosed reference transaction price for municipal securities that is meaningful and useful and whether particular methodologies are more or less costly to implement.

Finally, the MSRB could reduce or increase the size and/or value of customer transactions for which pricing reference information disclosures would be required. Alternative thresholds would provide confirmation disclosures to customers beyond those that transact in retail sizes. These could include providing disclosures to all customers, or to all customers that are not sophisticated municipal market professionals. The MSRB seeks comment on whether the 100 bonds or fewer or bonds in the par amount of $100,000 or less is an appropriate threshold and the degree to which a change in the threshold would increase or decrease costs associated with disclosure.

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.

4. **Assessing the benefits and costs, both quantitative and qualitative, of proposal and the main alternative regulatory approaches.**

The MSRB policy on economic analysis in rulemaking addresses consideration of the likely costs and benefits of the rule with the draft amendments fully implemented, against the context of the economic baselines discussed above.

The MSRB is able to identify some data to help quantify the economic effects of the proposal. For example, trade data from EMMA provides some insight

into the portion of retail-size trades in municipal securities to which a potential disclosure requirement might apply. However, additional information will be necessary to fully assess the economic effect of the proposal.

Benefits

The proposal is intended to provide additional information to retail investors and reduce the burden on retail investors for obtaining relevant information for purposes of the investor's understanding of the market for the traded security. The MSRB expects that the proposal will result in important benefits for investors who are customers in retail-size transactions. The MSRB expects that the proposal will promote a free and open market.

While EMMA has generally helped to make pricing information available and more accessible to the market, such information is generally directly beneficial only to those who actively seek it out and requires investors to make inferences about transactions. By requiring dealers acting in a principal capacity to disclose additional information to customers on the customer confirmation, the proposed rule would provide additional useful information and reduce the burden currently placed upon retail investors to actively search the EMMA database.

Costs

Our analysis of the potential costs does not consider all of the costs associated with the proposal, but instead focuses on the incremental costs attributable to it that exceed the baseline state. The costs associated with the baseline state are, in effect, subtracted from the costs associated with the draft rule to isolate the costs attributable to the incremental requirements of the proposal.

The proposal would likely require firms to modify their operational systems to identify reference transactions and provide the required disclosure on customer confirmations. For many firms, the reprogramming of existing systems may be costly. The MSRB seeks comments on the anticipated costs of such changes.

The MSRB is also requesting comments on whether the proposal could have unintended impacts on market behavior including, but not limited to: firms holding fewer bonds in inventory, firms holding more bonds in inventory, or dealers reducing service in retail-size trades.

Finally, the MSRB recognizes that, in some cases, additional information may cause customer confusion. The MSRB seeks comment on how this proposal could best ensure that customers receive relevant and useful information.

Effect on Competition, Efficiency, and Capital Formation

One of the likely effects of the proposal is that competition between dealers will be enhanced. Retail customers will have information that will allow them to make more informed choices about which dealers to use for future transactions, incentivizing dealers to offer competitive prices in retail transactions.

It is possible that the costs associated with the requirements of the proposal relative to the baseline may lead some dealers to reduce services to retail investors. In some cases, the costs could lead smaller dealers to consolidate with larger dealers or to exit the market.

The MSRB seeks public comment on the following questions, as well as any other comments on this topic, to assist it in determining whether to proceed with the development of a proposed pricing reference disclosure requirement for dealers. The MSRB particularly welcomes statistical, empirical, and other data from commenters that may support their views and/or support or refute the views or assumptions or issues raised in this request for comment.

1. Would the proposed disclosures provide investors with greater transparency into the compensation of their brokers or the costs associated with the execution of their municipal securities trades? Would the proposed disclosures help ensure investors receive fair and reasonable prices? What are the other potential benefits of the proposal?
2. What costs would this proposal impose on firms, including the cost of reprogramming the systems that create customer confirmations? Would such costs be mitigated by the coordinated approach of the MSRB and FINRA to this topic?
3. For what time period should the dealer's trades be disclosed? Is the same trading day standard appropriate in light of the objectives, costs and benefits of the proposal?
4. For which transactions should pricing reference disclosures be made?
    - Is it appropriate to provide that a dealer is only obligated to disclose pricing reference information when the customer trade is likely to be a retail trade? If so, should retail be defined by reference to the trade size, as in the proposal, or by some other standard?
    - Should there be any exclusions for certain types of transactions, notwithstanding the fact that they are retail-size transactions? For example, should the proposed disclosures not be required for new issue trades?

5. What are the viable alternatives to the proposal?
    - In lieu of the proposed disclosure of pricing reference information, should the MSRB require dealers to disclose their "markups" on "riskless principal" transactions as in the SEC's recommendation? If so, how could "riskless principal" transactions be defined to minimize market participant concerns?
    - Would the disclosure of additional information on EMMA meet some or all of the objectives of this proposal? If so, what information should be disclosed?
    - Is there a more principles-based approach that would achieve the objectives of the proposal?
6. To what extent, if any, do dealers already provide or make available such information or similar information to customers in any format?
7. Are there any situations in which pricing reference information that would normally require disclosure under the proposal should not require such disclosure?
8. When a firm executes multiple municipal securities transactions as principal, what should be the appropriate methodology or methodologies to use in determining the reference transaction price and differential to be disclosed on the confirmation? Are any of the methodologies referenced in this notice (*e.g.*, closest in time proximity to the customer trade or last in, first out) appropriate? Are there other methodologies that may be more appropriate?
9. Would the required disclosures encourage dealers to take actions to avoid making the proposed disclosures? For example: selling from inventory; taking a portion of securities from certain trades into inventory to avoid meeting the "reference transaction" definition; or holding securities until the relevant time period requiring disclosure has lapsed? If so, what effect might such actions have on the market? Would the risks associated with holding such securities in inventory weigh significantly against such actions?
10. For dealers with multiple market participant identifiers (MPIDs) registered to the same legal entity, what are the operational issues and associated costs with the proposal?
11. What information should be required to be disclosed on the customer confirmation?
    - Should the price differential between the customer's trade price and a reference transaction be disclosed as a percentage of par as in the proposal, or on a total dollar amount basis (*i.e.*, a differential that calculates the total dollar amount differential based on the number of bonds purchased or sold by the customer)? Should both be required to be disclosed? Is

there a better alternative to requiring the disclosure of the price differential?

- Should a reference transaction for which a dealer must disclose pricing information be more limited or more expansive in trade size? For example, should the proposal be limited to require only the disclosure of information pertaining to trade sizes that are identical to, or within a specified range as compared to, the customer trade size? Are the sizes that would currently require disclosure under the proposal over-inclusive or under-inclusive? For example, under the proposal, pricing information for a single trade that would otherwise meet the reference transaction definition, but that is in a trade size slightly below the customer trade size, would not require disclosure (*e.g.*, the customer purchased 100 bonds from the dealer, and the dealer purchased 95 of those same bonds on the same trading day). How probative would these disclosures be for retail investors?
- Should pricing information also be disclosed for transactions in which the dealer transacted on the side opposite the customer's side of the transaction (*e.g.* transactions in which the dealer sold the same securities to both the customer and another party)?

12. Should pricing information for a reference transaction between affiliates be required to be disclosed, as is currently the case under the proposal, or should the required disclosures be limited to transactions with other dealers or customers?
13. Would a requirement to disclose pricing reference information on the confirmation cause any problematic delays in sending the confirmation to a customer?
14. Do the disclosures have the potential to mislead or confuse investors to a degree that cannot be remedied by education, explanations or descriptions supplementing the disclosures?

November 17, 2014

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Text of Draft Amendments[26]

Rule G-15: Confirmation, Clearance, Settlement and Other Uniform Practice Requirements with Respect to Transactions with Customers

(a) *Customer Confirmations.*

(i) At or before the completion of a transaction in municipal securities with or for the account of a customer, each broker, dealer or municipal securities dealer shall give or send to the customer a written confirmation that complies with the requirements of this paragraph (i):

(A) – (E) No change.

(F) Pricing reference information. If the broker, dealer or municipal securities dealer is effecting a transaction as principal for 100 bonds or fewer or bonds in a par amount of $100,000 or less, the confirmation shall include:

(1) the price for any reference transaction (as defined in paragraph (a)(vi)(I) of this rule); and

(2) the difference in price between the reference transaction (as defined in paragraph (a)(vi)(I) of this rule) and the customer trade, expressed as a percentage of par.

(ii) – (v) No change.

(vi) Definitions. For purposes of this rule, the following terms shall have the following meanings:

(A) – (H) No change.

(I) The term "reference transaction" is a transaction in which the broker, dealer or municipal securities dealer transacts: (1) in a principal capacity; (2) with a third party to purchase or sell municipal securities; (3) in the same security as the customer; (4) on the same side of the transaction as the customer (as purchaser or seller); (5) on the same date as the customer transaction; and (6) in a single trade amount that equals or exceeds the size of the customer transaction or in a trade amount that, when combined with one or more other transactions that meet the requirements of clauses (1) through (5) of this paragraph, equals or exceeds the size of the customer transaction.

(vii) – (viii) No change.

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[26] Underlining indicates new language.

(b) – (g) No change.

Wachtel & Co Inc
1101 14th Street NW # 800
Washington, DC 20005

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

Jan 16, 2015

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

Established in 1961, Wachtel & Co Inc. is one of a shrinking number of small self-clearing broker/dealers.

We appreciate the opportunity to comment on FINRA Proposed Rule 2232. Although this rule is well intentioned, if implemented, it will have far reaching negative consequences regarding how bond business is conducted in this country and the structure of the industry. At a time when the problem of 'too big to fail' is an elephant in the room, we believe implementation of this rule will promote further industry consolidation. If enacted, the cost of systems to implement, and the continuing costs of compliance, will be disproportionately high for small firms, will not provide any meaningful information to customers, and will not stop the 'bad guys'. Proposed Rule 2232 specifically disadvantages small firms and is easily circumvented by large firms.

FINRA states that it is "concerned that investors in fixed income securities currently are limited in their ability to understand and compare transaction costs." We do not share this concern. Our experience is that investors in fixed income securities tend to be reasonably sophisticated – they understand current practices and are fully capable of evaluating the net price of a bond. Unsophisticated investors, on the other hand, are unlikely to desire, fully understand, or make use a confirmation disclosure. For all investors, sophisticated or not, members of this industry already have a duty to deal with them fairly. The proposed rule will not improve upon that obligation.

FINRA already has quite a few related and/or relevant rules such as **Rule 2120 Commissions Markups and Charges, Rule 2111 Suitability, Rule 2010 Standards of Commercial Honor and Just and Equitable Principles of Trade,** and **TRACE Rule Series 6700**. Mandatory 15 minute trade reporting for most bond transactions (recently expanded for more securities) is in place and access to Trace data is readily available. **FINRA monitors TRACE** data and is able to identify trades with mark-ups not within a close range. We suggest that FINRA send Requests for Information (or a team of examiners) directly to firms reporting such outlying trades and withdraw this proposal.

We believe that proposed Rule 2232 would provide little if any benefit to investors; however, it would definitely increase costs and decrease profits to all firms – that is not good regulatory policy.

A diverse financial community comprised of numerous small and medium sized firms is good for customers, issuers, the financing process, and the country. No actions should be taken that would have the effect of decreasing the number of small, stable, solid securities firms.

Respectfully submitted,

Wendie L Wachtel, COO Bonnie K Wachtel, CEO

FINANCIAL INFORMATION FORUM

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212-422-8568

Via Electronic Delivery

January 20, 2015

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

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

Re: MSRB Notice 2014-20 - Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations; FINRA Notice 14-52 - Pricing Disclosure in the Fixed Income Markets

Dear Mr. Smith and Ms. Asquith,

The Financial Information Forum (FIF)[1] would like to take this opportunity to comment on MSRB Notice 2014-20 - Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations and FINRA Notice 14-52 - Pricing Disclosure in the Fixed Income Markets ("Requests for Comment"). We appreciate the willingness of the MSRB and FINRA to seek feedback on these important issues in a coordinated manner and will respond to both notices in this comment letter.

With respect to the Requests for Comment, FIF respectfully makes the following recommendations:

1. Fully align efforts of MSRB and FINRA regarding these proposals
2. In order to minimize implementation challenges, consider the alternative approach of leveraging existing EMMA and TRACE data
    a. Add a link to EMMA and TRACE data on the customer confirmation
    b. Aggregate EMMA and TRACE data into a single website
    c. Perform a survey of retail investors to identify enhancements to EMMA and TRACE
    d. Further educate retail investors on EMMA and TRACE functionalities

FIF's perspectives on the proposals in the Requests for Comment are discussed in more detail below.

[1] FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the securities industry across the order lifecycle. Our participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

Aligning Efforts of MSRB and FINRA Imperative

FIF members appreciate that the MSRB and FINRA have taken a coordinated approach in proposals to require dealers to provide pricing reference information on retail customer confirmations. While the Requests for Comment issued by MSRB and FINRA are similar, there are differences in some of the details. For instance, in Example 7 of the Proposed Disclosure Requirement section of the FINRA Notice, the example requires the weighted average price of the firm's trades to be disclosed on the customer confirmation. In Example 9 of the same section, 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. These scenarios are not defined in the MSRB proposal and it remains unclear if the MSRB would mirror the FINRA requirements. We believe costs to dealers would increase exponentially if there are any variations between the FINRA and MSRB rules. FIF members urge MSRB and FINRA to be fully harmonized in any resulting regulations.

Significant Implementation Challenges as Proposed

These proposals will lead to operational and technological challenges that will increase costs to dealers as outlined below.

- Capturing trades to make sure dealers are tying principal trades to customer trades will be challenging. The process will be even more challenging for batch trades. Programming systems to match principal batch trades with customer trades would be a very complex process involving trade by trade matching. Enhanced audit trails will need to be built to validate system processes. Larger firms may have order management systems that can be modified to comply but smaller firms may end up having to do this manually. Matching principal and customer trades will be further complicated by trade cancels and rebills. This trade capture piece alone will lead to significant costs.
- Customer confirmations are currently produced at the time of the trade. All customer confirmations would need to be produced at the end of day in the proposed rule in case a corresponding principal trade is executed. Programming trading systems to wait until the end of the day to see if a corresponding trade is executed and adding information retroactively to the confirmation will be a costly, time-consuming task.
- Another programming challenge would be crafting systems to suppress resubmission of trades to regulators if a confirmation needs to be modified with pricing reference information at the end of the day. Systems would need to be able to recognize that this is a trade information modification affecting customer confirmations that does not require resubmission of the trade.
- The MSRB and FINRA proposals both apply to retail-sized transactions of 100 bonds or fewer or bonds in a par amount of $100,000 or less. Since the proposals are not limited to transactions of actual retail customers, institutional trades may fall within the parameters of these proposals. For the majority of FIF members, institutional trades flow through Omgeo's TradeSuite Institutional Delivery (ID)[2] via DTCC's ID System. Each transaction is confirmed and affirmed/matched through Omgeo's TradeSuite system, which distributes the affirmed confirmation to appropriate parties of the trade. If this rule applies to retail-sized institutional trades, the ID System may be required to add additional fields to the confirmations it generates to comply with the rule. The costs associated with implementing these fields at DTCC and Omgeo should be evaluated in the cost-benefit analysis for these proposals. To address this concern, FIF recommends limiting the parameters of these proposals to transactions of 99 bonds or fewer or bonds in a par amount of $99,000 or less. Doing so would eliminate potential

[2] TradeSuite ID is a 10b-10-compliant solution which automates messaging and settlement for equity and fixed income securities. It provides seamless connectivity from execution to settlement on domestic and cross-border trades of U.S. securities.

institutional trades or DVP/RVP transactions and therefore focus more on retail customer trades. This would make trading systems' programming logic to determine when pricing reference information should be on a customer confirmation much less complex. The best way to ensure that only retail trades are impacted is to clearly articulate in the proposal that the requirements only apply to accounts of natural persons.

Other Considerations

FIF members understand that the MSRB and FINRA would like to better inform retail investors. However, it is not certain that providing pricing reference information on retail customer confirmations will achieve this goal. Providing the price of the corresponding principal trade in comparison to the customer trade may be misleading. Overhead costs, such as compliance and technology, need to be factored into pricing securities in customer transactions. Additional information may need to be provided to customers explaining what their price represents and that there are other costs to broker dealers that are not strictly represented in the execution of the principal and customer trades. Providing this additional information to customers will continue to increase implementation costs. Furthermore, pricing reference information on customer confirmations could lead to some irrelevant data being reported to customers at the end of the day. While the fixed income markets fluctuate daily, customers could be receiving confirmations that show stale pricing as a result of intraday market movement. Overall, FIF members believe additional information on the confirmation may actually confuse customers as they will be seeing multiple prices listed. Customers may also wonder why they see additional information on only some of their trade confirmations and not on others.

FIF members would also like clarification on how to treat customer allocations of institutional-sized trades in the current proposals. If a broker dealer buys 500 bonds early in the day and sells 400 of those bonds to a customer later in the day, we understand that no pricing reference information would be required on the customer confirmation. If that client now requests separate allocations to sub accounts of 80 bonds to five different accounts, each of those allocation transactions would get a confirmation for the purchase of 80 bonds. Under these proposals, would those transactions require pricing reference information to be disclosed on the customer confirmations? There will always be a distinction between institutional and retail-sized pricing. Disclosing these markups to customers on confirmations may mislead customers as they won't be provided the context that the principal trade was an institutional-sized lot. FIF members request clarification on this scenario.

Recommendations

If the MSRB and FINRA decide to proceed with the proposals in the Requests for Comment, FIF members have the following recommendations:

- As mentioned above, ensure the MSRB and FINRA align efforts in any final regulations
- Eliminate institutional trades from the scope of these proposals
    - Add the definition of natural persons when determining which investors this rule will apply to. This will ensure the rules apply to retail customers only and will eliminate institutional trades from these regulations.
    - Apply the rule to retail customer trades of 99 bonds or fewer or bonds in a par amount of $99,000 or less, instead of the proposed 100 bonds or fewer or bonds in a par amount of $100,000 or less.

FIF members believe the MSRB and FINRA should consider alternate approaches to achieve their goal.

One step MSRB and FINRA could take is to require that broker dealers provide links or reference to EMMA and TRACE on customer confirmations. This would leverage the work that the MSRB and FINRA have already done to provide pricing reference information to retail investors and may expand the

awareness of these sources of data. Retail investors can utilize EMMA and TRACE data to acquire market information and evaluate the costs associated with their transactions. The MSRB and FINRA currently provide the ability for retail investors to identify same-day principal trades of the same security as their individual trades. We don't believe investors that utilize this information and actively seek it out would benefit from similar information on their customer confirmations. Realistically, customers would benefit much greater by using EMMA and TRACE in real-time compared to pricing reference on confirmations as they can obtain reference pricing information prior to submitting their trade. In this manner, we believe a link on customer confirmations to EMMA and TRACE data would satisfy the same goal as these proposals to better inform retail investors with much less implementation impact.

Additionally, MSRB or FINRA could aggregate all trade data available on EMMA and TRACE to provide a single website so customers can visit one place for all of this information. Dealers could then put a single link on customer confirmations further simplifying implementation.

The MSRB and FINRA could also survey retail investors to gauge their knowledge and usage of EMMA and TRACE. This could serve to inform retail investors of EMMA and TRACE benefits and functionalities, and bring to light ways to improve upon the accessibility of the data.

Finally, the MSRB and FINRA could further educate retail investors on EMMA and TRACE functionalities. Pricing reference information is already available on EMMA and TRACE. Creating summary documents or holding webinars that detail how to access information in EMMA and TRACE would allow for broader customer usage. Education combined with a survey and references to EMMA and TRACE on customer confirmations would lead to better informed retail investors.

In conclusion, FIF would like to thank the MSRB and FINRA for providing the opportunity to comment on the proposed changes. We look forward to a future meeting with DTCC, MSRB and FINRA in order to discuss the issues raised in the letter.

Regards,

Darren Wasney
Program Manager
Financial Information Forum

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January 16, 2015

Via: pubcom@finra.org
msrb.org/CommentForm

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

Mr. Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street
Suite 600
Alexandria, VA 22314

Re: Response to the Requests for Comment from FINRA and the MSRB on Proposed Rules to Require Confirmation Disclosure of Pricing Information in Fixed Income Securities Transactions (Regulatory Notices 14-52 and 2014-20).

Dear Ms. Asquith and Mr. Smith:

Thomson Reuters appreciates the opportunity to comment on the rule proposal by the Financial Industry Regulatory Authority ("FINRA") outlined in Regulatory Notice 14-52, which would require member firms to disclose the price to the member, the price to the customer and the difference between the two prices on customer confirmations for a subset of retail fixed income transactions. Through BETA Systems, Thomson Reuters[1] offers a complete suite of products that enable retail and institutional brokers to manage the daily tasks of their front, middle and back office operations. With more than 30 years of industry knowledge and hands-on experience, Thomson Reuters partner with some nineteen clearing firms and over 300 introducing broker-dealers to address their unique business and regulatory requirements.

Thomson Reuters believes this approach presents a significant amount of processing change and may not accurately reflect transaction details to investors. FINRA has presented a method for providing same-day pricing disclosures, which could be achieved in back office processing with significant code and processing changes. However, as a Service Provider, Thomson Reuters is concerned that a batch process will match trades by defined business rules, which could result in the pricing disclosure being irrelevant to the actual transactions. We illustrate our concerns through examples provided in the following section. We recommend that FINRA consider a process in which the pricing disclosure is actually related to the security transaction "at the time "of the transaction – the current standard in FINRA Rule 2121 and MSRB Rule G-30, which requires broker-dealers to take into consideration circumstances related "at the

[1] Thomson Reuters is the world's leading source of intelligent information for businesses and professionals. Combining industry expertise with innovative technology, it delivers critical information to leading decision makers in the financial and risk, legal, tax and accounting, intellectual property and science and media markets powered by the world's most trusted news organization. Headquartered in New York it employs approximately 57,800 people around the world and operates in over 100 countries. For more information about Thomson Reuters, please go to www.thomsonreuters.com. For more information about BETA Systems, please go to www.thomsonreuters.com/beta-systems.

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time" of transaction for fair prices and commissions. We believe EMMA and TRACE provides this information, since it is near real time. Firms could provide customers information related to their execution upon request, including detailing the price defined by a standard method or a fair market estimate. This would provide the needed customer disclosure and information and reduce the potential of making non relevant data as relevant. This is also similar to the Best Execution and Order Routing disclosures requirements.

Thomson Reuters details concerns below, and offers comments responsive to specific questions posed in Regulatory Notices 14-52 and 2014-20.

The Operational Complexities of the Proposals will Result in Reporting Information to Investors that is not Relevant to Their Transactions

Proposed revisions to FINRA Rule 2232 and MSRB Rule G-15 would require broker-dealers to disclose the price to the member, the price to the customer and price differential for transactions of qualifying size, when the member acts as principal on the same trading day in an amount that would meet or exceed the size of the customer transaction. Given the proposed scope of the amendments, Thomson Reuters is particularly concerned about three aspects from an operational and technical standpoint.

Determining what retail transactions qualify for the disclosure and what price to disclose as the broker-dealers price will be operationally complex and technically challenging. First, a broker-dealers's streetside executions and retail customer transactions are not related or aggregated systematically throughout the trading, meaning firms will have to build complex logic to compare all activity in dealer inventory and customer accounts in a particular security at the end of a trading day to determine whether the firm's dealer activity exceeded the aggregate customer activity in that security. Determining the appropriate member's price will be equally challenging because firms and service providers will have to develop functionality to evaluate the dealer and customer activity at the end of the trading day to determine which member price methodology is required (i.e. weighted average price, LIFO, closest in time proximity). This functionality will require a complicated tax lot-like system to link specific dealer activity and member price with customer activity for confirm reporting purposes, and account for the timing and amount of activity across multiple accounts and systems.

It was valuable that FINRA provided 13 examples in the regulatory notice, which the MSRB referenced in their Notice. However, these examples did not take into account the complexity associated with transaction processing. Generally a firm utilizes multiple order management systems and has several proprietary trading accounts, and their customers could be executing multiple transactions in the same fixed income securities, which will complicate the matching process and we believe this could result in irrelevant prices being legitimatized as the price the firm purchased or sold the security

Thomson Reuters offers the following examples to illustrate more complex trading scenarios that would require complicated matching logic in order to comply with the proposals:

Example 1:
10:00:00 AM Firm A, Trader 1 (INV Acct 1234), purchases 500 XYZ bonds from Dealer Y at $100 for $500,000
10:00:00 AM Firm A, Trader 2 (INV Acct 7890), purchases 50 XYZ bonds from Dealer Z at $102 for $51,000
10:00:15 AM Firm A, sells 30 XYZ bonds to Client A at $101.50 for $30,450

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Example 2:
10:00:00 AM Firm A, Trader 1 (INV Acct 9876), purchases 100 XYZ bonds from Dealer Y at $100 for $100,000
10:00:00 AM Firm A, Trader 2 (INV Acct 1234), purchases 50 XYZ bonds from Dealer Z at $102 for $51,000
10:00:15 AM Firm A, sells 75 XYZ bonds to Client A at a price of $101.50 for $76,125
10:00:15 AM Firm A, sells 30 XYZ bonds to Client B at a price of $101.50 for $30,450

Example 3:
09:30:00 AM Firm A, Trader 1 (INV Acct 2345), purchases 100 XYZ bonds from Dealer Y at $99 for $99,000
10:00:00 AM Firm A, Trader 2 (INV Acct 9876), purchases 50 XYZ bonds from Dealer Z at $102 for $51,000
10:00:00 AM Firm A, sells 80 XYZ bonds (INV Acct 2345) to Client A at a price of $101.50 for $81,200
10:10:00 AM Firm A, Trader 3 (INV Acct 4567), purchases 100 XYZ bonds Dealer Z at $101 for $101,000
10:15:00 AM Firm A, Trader 1(INV Acct 6543), purchases 100 XYZ bonds from Institution X at $100 for $100,000
10:20:15 AM Firm A, sells 30 XYZ bonds (INV Acct 6543)) to Client A at $101.50 for $30,450
10:00:15 AM Firm A, sells 50 XYZ bonds (INV Acct 4567) to Client B at a price of $101.50 for $50,750

The following illustrate instances in which the disclosure would be misleading or confusing to clients:

Example 4: Closest in Time Proximity Methodology
9:35:00 AM Firm A sells to Client A from existing inventory 50 XYZ bonds at $101 for $50,500
1:30:00 PM Negative news for XYZ
2:15:00 PM Firm A buys 100 bonds from Dealer Z at $93 for $93,000
2:30:00 PM Firm A sells to 50 XYZ bonds to Client B at $95 for $47,500

- Client A would receive a confirm reflecting dealer price of $93, a customer price of $101 and a price differential of 8.
- Client B would receive a confirm with a dealer price of $93, a customer price of $95, and a price differential of 2.

Example 5: Last In-FirstOut Methodology
10:00:00 AM Firm A buys 100 XYZ bonds at $99 for $99,000
10:15:00 AM Firm A sells to Client A 25 XYZ bonds at $101 for $25,250
10:18:00 AM Firm A sells to Client B 25 bonds at $101 for $25,250
1:00:00 PM Negative News for Company XYZ
1:15:00 PM Firm A buys 50 XYZ bonds at $92 for $46,000
2:00:00 PM Firm A sells to Client C 50 XYZ bonds at $94 for $47,000

- Client A and Client B will receive confirms disclosing dealer price of $92, customer price of 101, with price differential of 9 (prevailing market price and contemporaneous cost was $99 at time of customer transactions).

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- Client C will receive confirm disclosing dealer price of $92, customer price of $94, with price differential of 2.

Example 6: Weighted Average Price Methodology
10:00:00 AM Firm A buys 75 XYZ bonds at $98 for $73,500.
10:45:00 AM Firm A sells 75 XYZ bonds to Client A at $101 for $75,750
1:00:00 PM Negative news for XYZ
1:30:00 Firm A buys 75 XYZ bonds at $92 for $92,000
1:45:00 Firm A sells 75 XYZ bonds to Client B at $94 for $70,500

- Client A receives confirm disclosing a weighted average price of 95, customer price of 101, and price differential of 6.
- Client B receives confirm disclosing a weighted average price of 95, customer price of $94, and a markup of -1.

Example 7: Different confirms for same transaction
Day 1 – 10:00:00 AM Firm A purchases100 XYZ bonds at $99 for $99,000.
Day 1 – 11:30:00 AM Firm A sells Client A 50 XYZ bonds at $101 for $50,500
Day 2 – 2:00:00 PM Firm A sells Client A 50 XYZ bonds at $101 for $50,500

- Client A receives a confirm for Day 1 reflecting dealer price of $99 (LIFO), customer price of $101 and markup of 2.
- Client A receives a confirm for Day 2 reflecting customer price of $101 (even though transactions are identical, client receives different confirmations).

Example 8: Trade Corrections
Day 1 – 10:00:00 AM Firm A purchases 75 XYZ bonds from Dealer X at $97 for $72,750
Day 1 – 10:30:00 AM Firm A purchases 75 XYZ bonds from Dealer Z at $100 for $75,000
Day 1 – 11:00:00 Am Firm A sells 75 XYZ bonds to Client A at $100 for $75,000.
Day 1 – 2:00:00 PM Firm A sells 50 XYZ bonds to Client B at $101.50 for $50,750

- Client A receives a confirm reflecting dealer price of $100 (LIFO), customer price of $100 and price differential of 0.
- Client B receives a confirm reflecting dealer price of $100 (LIFO), customer price of $101.50, and differential of 1.5.

Day 2 – 9:00:00 AM Registered Rep makes trade correction for Client B, increasing quantity from 50 to 75 XYZ bonds.

- Trade correction would cause Day 1 Firm activity to equal customer activity, which would require firm to use the average price methodology. ***Would Firm A be required to issue a new confirm to Client B reflecting a dealer price of:***
  - $100 based on calculation used the prior day; or
  - $98.50 based on weighted average price?
- ***Would Client A have to be issued a corrected confirm if Firm is required to report $98.50 as dealer price?***

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Given these examples Thomson Reuters foresees additional processing logic that was not considered in the Regulatory Notices, and anticipates identifying additional challenges as analysis continues. Thomson Reuters believes the industry and regulators need to thoroughly evaluate all the potential scenarios to fully understand the complexity of reporting pricing disclosures and the accuracy of the disclosures under each scenario. As discussed above, automated processes are based on defined business rules which must account for unique events and complexities. Automated processes would facilitate processing client disclosures but at the expense of causing misleading price comparisons and legitimizing information that is irrelevant to the client's transaction. Importantly, Registered Representatives will not be able to disclose the actual markup to the client at the time of the transaction because the actual dealer price that will be the basis of the disclosure will not be calculated until the automated processes run after market close.

To reduce operational complexity and implementation costs, and allow firms to tailor their disclosure practices to their business models and technology infrastructure, FINRA and the MSRB should adopt a consistent and workable standard that:

- Allows firms to provide their retail customers fair and accurate price disclosure ;
- Determines dealer price using one consistently applied standard, rather than having to consider timing of activity and the extent to which dealer activity meets or exceeds customer activity;

Finally, service providers and print vendors, working with member firms will have to analyze existing confirm file layouts to ensure that information can be properly passed without causing unintended consequences downstream. As more fully detailed below, FINRA and the MSRB should consider alternatives to mitigate this risk and complexity by leveraging data that is already reported to TRACE or RTRS.

Regulatory Coordination

Thomson Reuters appreciates the manner in which FINRA and the MSRB have coordinated thus far on their respective confirm disclosure proposals, and stresses that the rules should diverge only to the extent necessary to account for differences between the municipal and corporate/agency markets. As a general matter, this type of coordination results in effective rulemaking, cost effective implementation for broker-dealers and regulators, and reduces implementation, technology and market risk. Thomson Reuters encourages FINRA and the MSRB to continue working with other regulators to address common regulatory concerns.

Thomson Reuters would also like to stress that FINRA and the MSRB should consider ways to consolidate rulemakings and implementation that impact common products, systems or processes. For instance, FINRA has released several proposals that impact various aspects of TRACE reporting and other proposals to increase market transparency.[2] Similarly, the MSRB has proposed transparency initiatives, along with its Long Range Plan for Market Transparency.[3] As FINRA and the MSRB consider the revisions proposed in Notices 14-52 and 2014-20, a critical objective should be to align

[2] Regulatory Notice 14-53 (Trade Obligations in TRACE-Eligible Securities); SR-FINRA-2014-050 (requiring a non-member affiliate indicator); and FINRA's announced proposal to require an indicator when a transaction does not reflect a commission or markup.

[3] Regulatory Notices 2014-14 (Enhancements to Post-Trade Transaction Data Disseminated Through a New Central Transparency Platform) and 2013-14 (Concept Release on Pre-Trade and Post-Trade Pricing Data Dissemination through a New Central Transparency Platform); Long-Range Plan for Market Transparency Products (http://www.msrb.org/msrb1/pdfs/Long-Range-Plan.pdf).

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implementation with other fixed income and market transparency initiatives. Consolidating related rulemakings in this way is more efficient for regulators and broker-dealers, and with this efficiency, broker-dealers can continue to invest in products, services and technologies that further benefit investors.

Assessment of Costs and Benefits – Economic Impact Analysis

Thomson Reuters believes that the costs and time to implement the proposed rule will be a significant undertaking, given it requires integration between multiple systems, new tax- lot like accounting application for matching trades and billing purposes and multiple changes downstream for processing, which will ultimately increase processing time for these transactions. As a point of comparison, the S.E.C. estimated in the 2010 proposal related to mutual fund disclosures that the one-time costs for broker-dealers to modify confirms was approximately $1.1 million (or aggregate cost of $180.7 million)..

Broker-dealers, FINRA and the MSRB have invested millions of dollars over the last several years in TRACE and RTRS reporting to capture additional detail for dealer and customer activity in fixed income securities. Thus, FINRA and the MSRB should work with the industry to enhance the existing TRACE Market Data and EMMA websites, which already aggregate and make publicly available significant amounts of trade related and pricing information. Moreover, as FINRA and the MSRB move forward with their market transparency initiatives, they will be in possession of more data which could be beneficial to investors if disclosed publicly. Leveraging the existing transaction repositories allows for consistency in disclosure, reduces burdens on investors by bringing the information together in two primary sources, and will arguably be of greater benefit to more investors by showing transaction costs and other reference information that investors will find useful. Broker-dealers could include links to the FINRA and MSRB facilities to further reduce the burden on investors. These alternatives must be considered before requiring broker-dealers to incur the significant costs of disclosures, which would only disclose a price based on a business rule, not a true indicator of the actual event (price).

Response to Specific "Request for Comment"

Thomson Reuters offers comments to the following questions raised in Regulatory Notices 14-52 and 2014-20:

MSRB and FINRA Question 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?

Response: Thomson Reuters anticipates that firms and service providers would incur costs in four distinct areas. Firms and service providers will have to engage technical resources to develop functionality to comply with identification and reporting requirements. Additionally, modifications will have to be made confirm programming and layouts. Technical and subject matter experts will also have to coordinate internal technical changes with print vendors and support end to end testing with other order management systems, service providers, and print vendors. Finally, firms will have to develop internal systems to ensure that they are able to adequately supervise and oversee the new requirements. An approach that aligns the FINRA and MSRB proposals to every extent possible will likely reduce implementation and maintenance costs.

MSRB Question 3. For what time period should the dealer's trades be disclosed? Is the same trading day standard appropriate in light of the objectives, costs and benefits of the proposal

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Response: Requiring the disclosure on any activity which occurs in the same trading day makes the proposal overly complex and costly to implement. As the MSRB notes, "as the time period between trades increases, the degree to which the price of the reference transaction will be helpful to the customer may decrease." Instead, the rule should be based on the existing standard in MSRB Rule 30, which requires broker-dealers to take into consideration circumstances "at the time" of transaction for fair prices and commissions.

MSRB and FINRA Question 4. For which transactions should pricing disclosures be made?

Response: Requiring disclosure on any activity which occurs in the same trading day makes the proposal overly complex and costly to implement. FINRA should limit scope to retail activity with a definition based on existing account or customer demographics that dealers already capture as books and records requirements rather than trade size. For example, the rule could apply to accounts that do not qualify as an Institutional Account[4] under Rule 4512 or accounts of natural persons.[5]

MSRB and FINRA Question 5. Are there alternative forms of disclosure or methods to achieve the objectives of the proposal and are they better suited that the proposal?

Response: Before adopting the rule, FINRA and the MSRB should review the current investor protections under Rule 2121 and G-30 or enhance FINRA's Market Data and MSRB's EMMA websites to disclose more pricing information publicly and consolidating this with the other reference and market data that is already consolidated and disseminated by FINRA and the MSRB. By leveraging the existing Regulators' facilities, information can be disclosed in a common form accessible in two locations for corporate bonds, agencies and municipal securities.

FINRA Question 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?

Response: While limiting scope to riskless principal activity may give the investor a more accurate representation of the costs to execute their particular transaction, Thomson Reuters is concerned that many operational challenges will persist, including the ability to accurately match riskless principal transactions real-time. Thomson Reuters does not believe that this will appreciably reduce the implementation cost or complexity for broker-dealers and service providers.

FINRA Question 9/MSRB Question 8. When a firm executes multiple municipal securities transactions as principal, what should be the appropriate methodology or methodologies to use in determining the reference transaction price and differential to be disclosed on the confirmation?

Response: Thomson Reuters believes strongly, as illustrated in the above examples that the proposed methodologies will result in misleading price comparisons and legitimize information that is irrelevant to the client's transaction. FINRA and the MSRB must consider an approach consistent with the "at the time of the transaction" standard of MSRB Rule G-30 and FINRA Rule 2121.

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[4] Since the FINRA definition of Institutional Account and the MSRB definition of sophisticated municipal market professional are the same, the rules could be harmonized in this respect.

[5] Natural person indicator will be a new requirement for broker-dealers under the S.E.C.'s money market fund reform and is a proposed requirement for FINRA's Comprehensive Automated Risk Data System.

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FINRA Question 11. Are there other potential effects to markets and market participants of the proposal?

Response:, Thomson Reuters would not be in favor of a pilot program to test potential effects. Cost of implementation is the same without the same level of certainty in the long-term investment, and further strains resources dedicated to other significant regulatory initiatives.

Conclusion

Thomson Reuters believes that the proposed rule is overly complex, may not necessarily achieve FINRA's intended goal of providing greater cost transparency for investors and that the potential costs far outweigh the potential investor benefits. Before submitting the rule for approval, Thomson Reuters requests FINRA to consider a more effective alternative that may have greater benefit to investors. If FINRA determines that confirm disclosures are necessary, Thomson Reuters recommends that FINRA adopt a rule that allows for standardized and consistent application o the regulatory requirements and reduces the likelihood of providing investors with misleading information.

Thomson Reuters appreciates this opportunity to comment on the rule proposal and welcomes the opportunity to further participate in discussions with FINRA and other stakeholders about how to best achieve the proposal's policy goals.

Respectfully Yours,

Kyle C. Wootten
Deputy Director – Compliance and Regulatory
Thomson Reuters

Regulatory Notice 15-36

Pricing Disclosure in the Fixed Income Markets

FINRA Requests Comment on a Revised Proposal Requiring Confirmation Disclosure of Pricing Information in Corporate and Agency Debt Securities Transactions

Comment Period Expires: December 11, 2015

October 2015

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
- MSRB Regulatory Notice 2014-20
- MSRB Regulatory Notice 2015-16
- Regulatory Notice 14-52
- SEA Rule 10b-10

Executive Summary

FINRA is requesting comment on a proposed rule that would require member firms to disclose additional information on customer confirmations for transactions in corporate and agency debt securities. FINRA initially sought comment on the proposed rule in *Regulatory Notice 14-52*. In response to the comments received, FINRA is proposing several changes to the proposed rule. These changes include replacing the size-based disclosure threshold with a retail customer standard; permitting firms to use alternate methodologies for calculating the reference price for more complex trade scenarios; requiring firms to add a link to TRACE on the confirmation; and proposing additional exceptions from the requirements.

FINRA and the Municipal Securities Rulemaking Board (MSRB) have discussed a coordinated approach to potential rulemaking in this area. The MSRB has published *Regulatory Notice 2015-16* soliciting comment on a revised proposal that differs from FINRA's proposal described herein. This *Notice* also invites comment on the MSRB's revised approach.

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.

FINRA
Financial Industry Regulatory Authority

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by December 11, 2015.

Comments must be submitted through one of the following methods:

- Emailing comments to *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.[1]

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).[2]

Background and Discussion

Initial Proposal

In *Regulatory Notice 14-52*, FINRA sought comment on a proposal to require firms to disclose additional pricing information for retail-size customer trades in corporate and agency debt securities.[3] Specifically, the proposal would require that, if a firm sells to a customer as principal and on the same day buys the same security as principal from another party, the firm would have to disclose on the customer confirmation (i) the price to the customer; (ii) the price to the firm of the same-day trade (reference price); and (iii) the difference between those two prices.[4] Under the initial proposal, the disclosure requirement would apply where the transaction with the customer was of a "qualifying size" of 100 bonds or less or bonds with a face value of $100,000 or less, which was designed to capture those trades that are retail in nature.

Revised Proposal in Response to Comments

FINRA received 30 comment letters in response to its initial proposal.[5] FINRA now seeks comments on a revised proposal. The significant differences between the initial proposal and the revised proposal include:

- replacing the "qualifying size" threshold with a retail customer account standard;
- permitting firms to use alternative methodologies for calculating the reference price for more complex trade scenarios;
- permitting firms, in the event of a material change in the price of the security between the time of the firm principal trade and the customer trade, to omit the reference price;
- requiring a link to TRACE data on confirmations that are subject to the disclosure requirement;
- providing an exemption to the proposed disclosure requirements for transactions that are part of a fixed price new issue and are sold at the fixed price offering price;
- excluding firm principal trades that are executed on a trading desk functionally separate from the retail trading desk for purposes of calculating a reference price; and
- excluding firm principal trades with affiliates for positions that were acquired by the affiliate on a previous trading day.

A. Criteria For Triggering Disclosure

In the initial proposal, FINRA proposed that the disclosure requirement would apply where the transaction with the customer was of a "qualifying size" of 100 bonds or less or bonds with a face value of $100,000 or less. This qualifying size standard was designed to capture those trades that are retail in nature. Commenters indicated that the 100-bond standard may be difficult to implement, whereas a retail/institutional account identification is already used in firms' business processing and therefore would be simpler to apply. Accordingly, FINRA proposes to replace the qualifying size requirement with an exclusion for transactions that involve an institutional account, as defined in FINRA Rule 4512(c).[6] This would ensure that all eligible transactions involving non-institutional customer accounts, regardless of size or face amount, would be subject to the proposed disclosure.

B. Alternative Methodologies for More Complex Trades

The initial proposal set forth several methodologies that firms should apply when there are multiple firm trades equaling or exceeding a customer trade, which could potentially contribute to the determination of the reference price for purposes of the proposed disclosure. These methodologies consisted of average weighted price, last in, first out, and closest in time. Commenters raised concerns about the operational burdens associated with determining the reference price for these "complex" trade scenarios and said that determining the reference price would be difficult and costly.[7] Commenters also indicated

that differing methodologies would result in inconsistent disclosures for similar customer trades on the same trading day. In response to these comments, FINRA is proposing to provide flexibility to establish alternative methodologies in certain instances.

In non-complex scenarios, where there is a non-institutional customer transaction and a firm principal transaction of the same or greater size without intervening principal trades within the same trading day, determining the reference price to include on the confirmation is straightforward. FINRA therefore is proposing that the price of the principal trade should be used as the reference price for these scenarios.[8]

However, where there is not a same (or greater) size principal and customer trade scenario or there are one or more intervening principal trades of a different size, the proposal would allow firms flexibility in calculating the reference price.[9] In such scenarios, firms may employ a reasonable alternative methodology, such as the average weighted price of the firm trades that equal or exceed the size of the customer trade, or the price of the last same-day trade executed as principal by the firm prior to the customer trade (or closest in time if executed after), irrespective of the size of that principal trade.[10] The firm must adequately document and consistently apply its chosen methodology.[11]

Attached as Attachment B is a more detailed description of the guidelines firms must follow when establishing a reference price with specific examples.

C. Material Changes to the Price of the Security

Some commenters also raised concerns about scenarios where there is a material change in the market price, due to, for example, a credit downgrade or breaking news regarding the obligor. These commenters indicated that customers may be confused by reference price information provided on trading days where there are large price swings between the time of the trade with the customer and the firm's own trade. These scenarios do not necessarily involve operational difficulties in calculating the reference price; rather, firms are concerned the reference price may be confusing or misleading.[12]

In response to these comments, the proposal would permit firms to either not disclose the reference price, or disclose with the reference price clarifying information, where the firm can demonstrate that there was an unusual and material change in the price of the bond between the time of the firm principal and the customer transactions. This provision is not intended to be used when the price of the security has changed due to normal price fluctuations or general market volatility. Firms may use this provision when the material change in the price of the security has occurred due to a material event such as a credit downgrade or breaking news. A firm that elected not to disclose the reference price under this provision would be required to demonstrate that there was a material change in the price of the security between the time of the firm and the customer transactions.

D. Link to TRACE Data

Several commenters advocated replacing this proposal with a variety of methods of providing TRACE data to customers. However, FINRA believes that access to TRACE data alone is insufficient because an investor may not be able to use TRACE to identify precisely the principal trade that was made by that investor's broker-dealer, and thus would not be able to ascertain the exact amount of the price differential between the firm and customer trade. FINRA agrees that TRACE data can help customers understand the market at the time of the customer's transaction, and that investors should be encouraged to access this information. FINRA is therefore proposing that firms also be required to provide a link to TRACE on the customer confirmation. FINRA also invites comment on other ways, in addition to the proposed requirement that firms include a link to TRACE on the confirmation, in which it could make TRACE data more accessible to investors.

E. Fixed Price New Issues

Some commenters indicated that new issues should be exempted from the proposal, as primary offerings already provide significant disclosure through offering memoranda. In response, FINRA proposes to exclude transactions that are part of fixed price offerings and are sold at the fixed price offering price on their first trading day from the proposed disclosure. However, in contrast, variable price offerings are reported as secondary trades, may involve investors paying different prices, and may be difficult for firms to distinguish from other kinds of secondary trades. Therefore, the revised proposal would continue to apply the proposed disclosure requirements to transactions that are part of variable price offerings.

F. Trades That Occur on Functionally Separate Desks

The initial proposal required disclosure if a firm principal trade occurred on the same day as a customer trade of Qualifying Size and did not distinguish between where the firm principal trade originated within the firm for purposes of triggering the disclosure requirements. Some commenters noted that having the disclosure requirements triggered by trades that were made by separate trading departments or desks would undermine the legal and operational separation of those desks, and may not be relevant in determining the reference price. In response to comments, FINRA proposes to exclude firm-side transactions from the proposed disclosure that are conducted by a department or desk that is functionally separate from the retail-side desk, *e.g.*, where the firm can demonstrate through policies and procedures that the firm-side transaction was made by an institutional desk for an institutional customer that is separate from the retail desk and the retail customer. This exception would not apply, however, where the transaction of the separate department or desk is related to the other desk, *e.g.*, if the transactions and positions of a separate department or desk are regularly used to source the retail transactions at the other desk.

G. Positions Acquired by an Affiliate on a Previous Trading Day

As discussed above, the initial proposal did not distinguish between the types of firm principal trades that would trigger disclosure. Some commenters indicated that a broker-dealer affiliate may hold securities in inventory with any subsequent trades between affiliates being more akin to a back-office transfer. In those situations, commenters indicated that the original acquisition time period of the securities should be used to determine whether the disclosure requirements are triggered. In response to this comment, FINRA proposes to exclude trades where the member's principal trade was executed with an affiliate of the member and the affiliate's position that satisfied this trade was not acquired on the same trading day.

MSRB Proposal

As noted above, the MSRB also published a notice soliciting comment on a revised proposal.[13] As described in detail in the MSRB's notice, the MSRB's approach differs from FINRA's proposed approach described above and would require disclosure of the amount of the firm's mark-up (or mark-down) for certain retail customer transactions, rather than the reference price paid by the firm and the differential between the reference price and the price paid by the customer. Under the MSRB's proposal, the firm would be required to disclose its mark-up or mark-down from the prevailing market price of a security if the firm traded as principal with a non-institutional customer within a discrete time window (*e.g.*, the firm purchased the security in the two hours preceding the sale to the customer, or sold the security in the two hours following the purchase from the customer). [14] While FINRA and the MSRB's revised proposals currently differ, both entities favor a coordinated approach. Accordingly, FINRA is inviting comments on the MSRB's proposal in comparison to FINRA's revised proposal, and whether the MSRB's proposal, or elements of the proposal, may be an appropriate alternative to FINRA's revised proposal.

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 associated with their purchases and sales. FINRA's analysis of TRACE data for the first quarter of 2015 finds a material difference between the median mark-up/mark-down and the tail of the distribution, indicating that some customers paid considerably more than others in similar trades.

Economic Baseline

The revised proposal would impact broker-dealers in the retail market of corporate and agency debt securities by imposing confirmation disclosure requirements on certain customer transactions. FINRA has analyzed TRACE data for the first quarter of 2015 to better understand the transactions and firms affected by the proposal. Since TRACE data cannot differentiate between retail and institutional transactions, the staff focused on customer trades of 100 bonds or less, which is intended to capture those trades that are retail in nature.[15]

In the first quarter of 2015, the average daily number of retail-sized customer trades (100 or fewer bonds) was 20,510 in corporate debt securities and 768 in agency debt securities. More than half of the corporate bond transactions were in investment grade securities. For both corporate and agency debt securities, approximately 75 percent of the retail-sized customer trades in the first quarter of 2015 were less than 40 bonds. The transactions of interest were also concentrated among large firms. For example, the top 20 broker-dealers with the highest volumes accounted for roughly 70 percent of the transactions for both corporate and agency debt securities.[16]

FINRA also estimated mark-ups and mark-downs on customer trades in corporate and agency debt securities during the first quarter of 2015.[17] This analysis shows that there was a material difference between the median mark-ups and mark-downs and the tail of the distribution. For example, for retail-sized investment grade corporate debt transactions the median estimated mark-up on customer buy orders was 0.51 percent whereas the 95th percentile was more than four times higher (2.22 percent), suggesting that while the mark-up was half a percent or less on 50 percent of these orders, 5 percent of the orders had mark-ups of more than two percent.[18] These results indicate that some customers paid considerably more than others in similar trades.[19] These differences were also significant for high-yield and unrated securities. For example, the median retail-sized corporate debt transactions in high-yield and unrated securities was 0.71 percent and the 95th percentile was 2.68 percent.[20]

FINRA also examined the time period separating the customer trades and the corresponding principal trades during the first quarter of 2015. This analysis reveals that approximately 93 percent of retail-sized customer trades in corporate debt securities with same-sized corresponding principal trades occurred within 10 minutes. Similarly, customer and principal trades occurred within 30 minutes of each other for approximately 96 percent and within 2 hours for more than 98 percent of the trades.[21] For trades involving two or more different sized offsetting transactions, the maximum time interval separating the trades was within 10 minutes for approximately 58 percent, and within 2 hours for 82 percent of the trades.

Economic Impact

As discussed above, the proposal would impact broker-dealers in the retail segment of the corporate and agency debt securities market. To assess the economic impacts associated with the proposed rule change, FINRA reviewed retail-sized customer trades (100 bonds or less) during the first quarter of 2015 to analyze trades that would trigger the disclosure requirement.[22] During this period, there were a total of 826,965 customer trades in corporate debt securities. FINRA estimates that 481,726 (or 58.25 percent) of these trades would be subject to the disclosure requirement. These disclosure-eligible trades were reported by over 800 dealers but were concentrated among large dealers. For example, consistent with the estimates based on all retail-sized customer trades discussed above, the top 20 broker-dealers with the highest number of disclosure eligible retail-sized customer trades accounted for more than 66 percent of these transactions in corporate debt securities.[23] The top 5 dealers alone accounted for more than 36 percent of the corporate debt transactions.

FINRA also examined the trades that would fall under the complex and non-complex trading scenarios discussed in this proposal. As discussed above, non-complex scenarios comprised a customer transaction and a firm principal transaction of the same or greater size without intervening trades within the same trading day. FINRA estimates that at least 76 percent of the disclosure-eligible customer trades in corporate and agency debt securities had corresponding principal trades without intervening trades. In such non-complex scenarios, dealers would be required to disclose the price of the corresponding principal trade as the reference price on the confirmation disclosures. FINRA also estimated the differential between the prices on the customer trades and the corresponding reference prices on principal trades for these non-complex trades. The average price differential in corporate debt securities was 0.73 percent and in agency debt securities was 0.43 percent.[24] Consistent with the mark-up and mark-down analysis discussed above, there was a material difference between the median price differential and the tail of the distribution, which suggests that some customers paid considerably more than others in similar trades. For example, for retail-sized corporate debt transactions the median estimated price differential was 0.48 percent whereas the 95th percentile was much higher at 2.19 percent.[25] These non-complex corporate debt trades were reported by 806 dealers but were concentrated among a few large dealers. For example, the top 20 dealers based on number of disclosure eligible trades accounted for approximately 67 percent of the transactions in corporate debt securities.

FINRA estimates that for approximately 24 percent of the customer transactions in corporate debt securities that would be subject to the disclosure requirement, there were one or more intervening trades of different size. As discussed above, in these complex trading scenarios firms would have flexibility in calculating the reference price. Firms may use a reasonable methodology, such as the average weighted price of the firm trades that equal or exceed the size of the customer trade or the price of the last same-day trade

executed as principal by the firm prior to the customer trade (or closest in time if executed after). FINRA estimates that the average price differential between the prices on the customer trades and the corresponding reference prices for these complex trades was 1.06 percent in corporate debt securities and 0.34 percent in agency debt securities.[26] As with non-complex trading scenarios, there was a material difference between the median price differential and the tail of the distribution for these complex trades as well.[27] Similarly, while the complex trades in corporate debt securities were reported by 443 dealers, they were concentrated among large dealers, with the top 20 broker-dealers (based on number of disclosure eligible trades) accounting for approximately 64 percent of the eligible corporate debt transactions.[28]

Benefits

As with the initial proposal, 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.[29] By providing additional pricing information to customers, this proposal may encourage customers to seek out other dealers that might offer more competitive prices. Accordingly, dealers may be incentivized to offer more competitive prices to their retail customers. Any resulting reduction in the differential between the reference price and the price paid by the customer would reduce transaction costs paid by investors and enhance investor confidence. Increase in investor confidence may also encourage wider participation by investors in the retail segments of the corporate and agency debt market.

Costs

As with the initial proposal, 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. Accordingly, firms would likely incur costs associated with updating operational systems and procedures to identify customer transactions that would be subject to disclosure, costs associated with conveying the disclosure on the customer confirmation, cost of including a link to TRACE on the customer confirmation, and costs associated with adopting policies and procedures to ensure continued compliance with this proposal. FINRA specifically requests comments on the sources and quantified estimates of these costs and will estimate these costs based on the information obtained through the public comment process.

FINRA understands that some firms generate confirmation statements directly following trade execution while others generate confirmations in batches at the end of the day. The costs associated with this proposal may be different depending on the processes that firms rely upon to generate confirmations. FINRA specifically seeks comment on the types of processes firms use to generate confirmations and how the proposal might have differential impacts based on these processes. FINRA requests data and quantified comments where possible.

However, FINRA believes that changing the scope of the proposal to require disclosure for non-institutional accounts may lessen some of the costs and complexity associated with this proposal by allowing firms to use an existing distinction that already is integrated into their operations. Similarly, FINRA believes that providing flexibility to use an alternative methodology for more complex trading scenarios also will lessen the costs and burdens on firms. FINRA does not believe that requiring firms to add a link to TRACE on the customer confirmation will create a significant business or operational impact for firms, but requests comment on the potential impact.

While permitting firms to use alternative methodologies for more complex trading scenarios will lessen the costs and burdens on firms, FINRA notes that it will also make it more difficult for potential consumers of this information to evaluate transactions within and across firms, reducing comparability to customers. In addition, the flexibility may increase FINRA's market surveillance and rule enforcement costs.

FINRA is requesting comment on the potential costs that the revised proposal may impose on firms. FINRA is also requesting comment as to whether the revised proposal may have an unintended negative impact on dealer behavior. FINRA requests data and quantified comments where possible.

Regulatory Alternatives

FINRA recognizes that there are alternatives to the proposed approach of requiring disclosure of pricing information for trades in the same security where the firm principal and the customer trades occur on the same trading day. As discussed above, the MSRB is proposing to require disclosure of the amount of the firm's mark-up (or mark-down) for certain retail customer transactions, rather than the reference price paid by the firm and the differential between the reference price and the price paid by the customer. Under the MSRB's proposal, the firm would be required to disclose its mark-up or mark-down from the prevailing market price of a security if the firm traded as principal with a non-institutional account within a discrete time window (*e.g.*, the firm purchased the security in the two hours preceding the sale to the customer, or sold the security in the two hours following the purchase from the customer).

While FINRA believes its revised approach is likely to result in more consistent disclosures for a greater number of retail customers,[30] FINRA notes that, in many circumstances, the revised FINRA approach and the MSRB's mark-up disclosure approach would produce similar outcomes. For example, where there is a 1:1 match in a short duration of time with no intervening trades or material price movement, the mark-up/differential disclosed would be the same under the mark-up disclosure approach and the revised proposals. Similarly, if a firm was using a last-in-time methodology for calculating its reference price in a more complex trading scenario, and the price for that bond did not change significantly between the time of the firm's last purchase and the time of the trade with the customer, the differential between the price to the firm and the price to the customer would likely be comparable to the firm's mark-up calculation.

Some commenters also suggested a shorter timeframe for purpose of triggering the disclosure requirement, such as 15 or 30 minutes. While the TRACE data indicated that a majority of firm and customer trades occur within 30 minutes of each other, FINRA continues to believe that requiring disclosure for a broader time span of within the same trading day will capture additional customer trades that would benefit from the proposed disclosure and should not be excluded. FINRA also believes that a same-trading day standard will help reduce the concern that a firm might delay trading activity to avoid triggering the disclosure requirements, as it would be less likely that a firm would hold a position overnight solely to avoid the proposed disclosure requirement.

Some commenters also suggested that the proposed disclosure only be triggered where the customer trade is part of a riskless principal firm trade. FINRA believes using the riskless principal standard is too narrow[31] and often may be difficult to objectively define and implement for fixed income securities. As noted above, TRACE data indicates that there is a variance in the price differential in both riskless principal trades and trades that would not be considered riskless principal, therefore again supporting the notion that disclosure in all cases will be valuable.

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 the mark-up disclosure 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 revised 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. In comparison to the initial proposal, does the revised proposal alter the anticipated benefits to investors?
   - Does the revised proposal alter the ability of investors to evaluate the cost and quality of the services that firms provide, and help ensure that customers receive fair and reasonable prices?
   - Does the revised proposal alter investors' ability to obtain greater transparency into the compensation of their broker-dealers or the costs associated with the execution of their fixed income trades?
2. What kinds of costs would the revised proposal impose on firms?
   - What are the anticipated costs to firms in developing and implementing systems to comply with the revised proposal? What are the anticipated on-going costs associated with this revised proposal?
   - What are the estimates of these costs, including costs associated with updating operational systems and procedures to identify customer transactions that would be subject to disclosure, costs associated with conveying the disclosure on the customer confirmation, cost of including a link to TRACE on the customer confirmation, and costs associated with adopting policies and procedures to ensure continued compliance with the revised proposal? What are the assumptions that underlie these estimates? To what extent do these estimates differ across 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 to comply with the revised proposal? What are those modifications?

4. What factors might explain differences in mark-ups and mark-downs realized by retail transactions within the same security in the corporate and agency debt market? FINRA requests data and quantified comments.
5. Do dealers have adequate guidance to distinguish between "complex" and "non-complex" trading scenarios discussed in this proposal? If not, specifically what additional guidance would be helpful?
   - What methodologies are the dealers anticipated to employ for calculating reference prices in the complex trading scenarios?
6. Does providing flexibility to the dealers in calculating reference prices for complex trades diminish the value of these disclosures to the investors?
7. In eliminating the Qualifying Size requirement in favor of a retail customer standard, does the revised proposal better address the universe of transactions that should require confirmation disclosure?
   - Is the definition of an institutional account as set forth in Rule 4512(c) appropriate for purposes of the revised proposal?
   - Should the proposal use the term institutional investor as set forth in Rule 2110(a)(4)[32] either instead of, or in addition to, the institutional account standard that is currently proposed?
   - Should the proposal apply to investment advisory accounts or participant-directed plans that would otherwise be excluded?
8. Are the proposed exceptions for fixed price new issues, trades involving functionally separate desks or departments, and transactions between affiliates for positions that were acquired on a previous trading day appropriate?
9. Is it appropriate to allow firms to not disclose the reference price in the event of a material change in the market price for the security?
10. Real time TRACE data is available free of charge on the FINRA site for personal, non-commercial use. In addition, FINRA policy, as per Rule 7730, allow for re-distribution of real time TRACE data for personal, non-commercial use free of charge.
    - In addition to, or instead of requiring firms to provide a link to TRACE on the confirmation, are there are other ways to increase investors' awareness of, and ability to access, TRACE data? For example, should FINRA allow firms the option of making TRACE data available to their customers via their own customer portal (website)?

11. In its revised proposal, the MSRB is proposing that firms disclose the mark-up both as a total dollar amount and as a percentage of the principal amount of the customer transaction. Should FINRA also consider requiring firms to disclose additional information about the reference price, such the percentage of the price differential or a total dollar amount differential?

12. In its revised proposal, the MSRB is proposing to require firms to "look through" a transaction with an affiliated broker-dealer and use that affiliated broker-dealer's transaction with a third party in determining whether disclosure is required, and the mark-up to be disclosed. For purposes of determining whether disclosure is required, and the reference price to be used, should FINRA also consider adopting a similar affirmative requirement that would look through a firm's same-day transaction with an affiliated broker-dealer to the price of that affiliate's trade with a third party?

13. In its revised proposal, the MSRB is proposing to require firms to provide a link to EMMA on all trades with non-institutional accounts, not just those trades that are subject to the proposed disclosure requirement. Should FINRA also consider adopting this requirement?

14. In its revised proposal, the MSRB is proposing, on all trades with non-institutional accounts, to require firms to disclose the time of execution, accurate to the nearest minute, of the customer's trade. Should FINRA also consider adopting this requirement? What are the potential benefits and drawbacks of this requirement?

15. If a firm elects to use an alternative methodology for purposes of calculating the reference price, should the firm be required to describe the methodology that was used? If so, would it be appropriate for a firm to make this disclosure on its website, or through some other means?

16. The revised proposal would require firms, for purposes of establishing the reference price, to consider trades where the firm principal trade was with another customer. Would an alternative methodology be appropriate for calculating the reference price in these cases?

17. Are there alternative forms of disclosure or methods to achieve the objectives of the revised proposal and are they better suited than the revised proposal?

- As discussed above, the MSRB is proposing to require a firm to disclose its mark-up (or mark-down) from the prevailing market price of a security if the firm traded as principal with a non-institutional account within a discrete time window (*e.g.*, the firm purchased the security in the two hours preceding the sale to the customer, or sold the security in the two hours following the purchase from the customer).

- Are there benefits to this alternative that are not present in the revised proposal?
- Are there limitations to this alternative that are no present in the revised proposal?
- What would be the costs to firms to implement such an alternative disclosure? What are the assumptions that underlie those cost estimates?
- Should FINRA require similar disclosure instead of the revised proposal?

- Instead of requiring firms to calculate a reference price for every eligible trade, should firms be permitted to state that the firm's mark-up/mark-down will not exceed a certain specified figure unless otherwise disclosed, *e.g.*, 0.50 percent, and require firms to disclose mark-ups/mark-downs in excess of that figure?

18. In comparison to the initial proposal, would the revised proposal differently impact markets and market participants?

- Would the revised proposal alter the incentives and dynamics of the broker-customer relationship, result in decreased liquidity in the fixed income market, cause firms to reduce service in retail-sized trades, or encourage firms to trade with customers as principal from inventory?
- How should FINRA measure and assess these potential effects against the benefits the proposal might create?
- In comparison to the initial proposal, would the revised proposal differently impact markets and market participants?
- Are there other potential economic impacts to market participants of the revised proposal? Would the proposal alter the incentives and dynamics of the broker-customer-relationship? FINRA requests data and quantified comments.

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 MSRB issued a companion notice soliciting comment on a substantially similar proposal applicable to municipal securities. *See* MSRB *Regulatory Notice 14-20* (November 2014).

4. In the case of a sale to a customer, the proposal would apply to instances where the firm bought bonds as principal both prior to, and after, it sold bonds to the customer. The proposal would also apply to instances where the firm buys bonds from a customer and sells the same bonds as principal to another party on the same trading day. In that scenario, the proposal would apply to instances where the firm sold bonds as principal both prior to, and after, it bought bonds from the customer.

5. The comments received in response to *Regulatory Notice 14-52* are available on FINRA's website at www.finra.org/notices/14-52.

6. Rule 4512(c) defines an institutional account as an account of (1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million.

7. The scenario was also raised where a firm trade used to calculate the reference price is later cancelled on a subsequent trade date. In such a scenario, FINRA would not require the firm to recalculate the reference price or re-issue a confirmation, but the firm would be permitted to do so at its discretion.

8. Using data from the first quarter of 2015 for corporate bonds, FINRA observed that approximately 42 percent of retail-size customer trades (100 bonds or fewer) had same-size corresponding principal trades on the same trading day. In addition, for these trades, the customer and principal trades occurred within 30 minutes of each other in approximately 96 percent of those trades.

9. Using data from the first quarter of 2015 for corporate bonds, the percentage of retail-sized trades that have off-setting firm trades (both same-size or that otherwise satisfy the customer trades) increases to 58.25 percent. For this universe of retail trades, the principal and the customer trades occurred within thirty minutes of each other in over 88 percent of those trades.

10. For the disclosure requirements to apply, there still must be an offsetting principal trade on the same day that meets or exceeds the size of the retail customer trade.

11. While FINRA believes that firms should be provided flexibility in calculating the reference price in more complex scenarios, FINRA notes that greater flexibility reduces the comparability of such disclosure across firms.

12. FINRA's data indicated that, where retail-size trades had a same-size match with a firm trade on the same trading day, over 96 percent of those matched trades occurred within 30 minutes of each other, meaning that concerns about intervening volatility or news between the firm and customer trade, while possible, are not typical and that the close time proximity of the trades further supports that the pricing information would be valuable to investors.

13. *See* MSRB *Regulatory Notice 2015-16*.

14. As described in the MSRB's notice, the prevailing market price for the customer's security would presumptively be established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with applicable MSRB rules. *See MSRB Regulatory Notice 2015-16*.

15. This analysis is both under-inclusive relative to the proposal, as it does not include retail transactions of larger size, as well as over-inclusive, as it includes non-retail trades of smaller size. Nonetheless, FINRA believes that the analysis provides useful initial evidence around an economic baseline.

16. The top 5 dealers alone accounted for more than 37 percent of the corporate bond transactions and over 34 percent of the agency debt transactions.

17. The mark-up and mark-down calculations involved matching customer trades to offsetting same-day principal trades by the same dealer in the same CUSIP. This included matching same-sized trades as well as trades of different sizes where there was no same-sized match (*e.g.*, a customer buy of 100 corporate bonds matched to two principal sells of 50 corporate bonds each). The markups (mark-downs) on customer buys (sells) correspond to the percentage difference in price in customer trades and the offsetting principal trade. In cases when the offsetting principal trade was also a customer trade, the combined mark-up and mark-down ("spread") on these roundtrip transactions was calculated as the percentage difference in price between the customer buy and the customer sell.

18. The median mark-down on these retail-sized investment grade corporate debt transactions was 0.44 percent and the 95th percentile was 1.57 percent. The corresponding two-way median spread (combined mark-up and mark-down on these roundtrip transactions) and the 95th percentile were 0.07 percent and 2.81 percent, respectively. These estimates are consistent with the academic literature on the impact of transparency and transaction costs in the corporate bond market. For example, Goldstein, Hotchkiss & Sirri (2007) estimated average two-way spreads on BBB corporate bond trades within the same day. The authors' estimates of transaction costs for retail sized trades measured in groupings from less than 10 bonds through 51-100 bonds range from 0.85 percent to 2.35 percent for a period pre- and post- introduction of public TRACE reporting. Consistent with FINRA's analysis, the authors report a material difference between the median transaction costs and the tail of the distribution. For example, the authors find that the median two-way spreads range from 0.38 percent to 2.25 percent whereas the corresponding 99th percentiles were significantly higher, ranging from 4.88 percent to 6.26 percent. Overall, the authors show that the introduction of transparency in the corporate bond market led to a decline in transaction costs. This finding is consistent with other studies, such as Edwards, Harris, and Piwowar (2007) and Bessembinder, Maxwell, and Venkataram (2006), who also find that transparency reduced transaction costs in the corporate bond market.

19. Similarly, the median mark-up and the 95th percentile for agency debt transactions of 100 bonds or less were 0.11 percent and 1.78 percent, respectively. These differences between the median mark-up/mark-down and the tail of the distribution also remain material across transactions of varying sizes within retail-sized corporate and agency debt transactions. For example, the median mark-ups for corporate debt transactions of less than 10 bonds, between 10 and 40 bonds, between 40 and 70 bonds, and between 70 and 100 bonds were 0.32 percent, 0.75 percent, 0.73 percent and 0.61 percent, respectively whereas the corresponding 95th percentiles were significantly higher (2.11 percent, 2.40 percent, 2.54 percent and 2.54 percent).

20. The difference between the median mark-up or mark-down and the tail of the distribution also remains material after accounting for differences in security characteristics. For example, the staff calculated the difference between the median and the 95th percentile mark-up and mark-down by CUSIP for all securities that had 50 or more customer trades and corresponding principal trades during the first quarter of 2015. This analysis shows that the difference between median markups and mark-downs and the tail of the distribution continues to remain material across a range of securities. For example, the difference in mark-ups and mark-downs exceeds 1.04 percent for half of the individual corporate debt securities and exceeds 1.47 percent for a quarter of the corporate debt securities. These findings suggest that the material difference between median markups and mark-downs and the tail of the distribution is not driven solely by differences in characteristics of the underlying securities.

21. These statistics were similar for trades in agency debt securities. For example, customer trades with same-sized corresponding principal trades occurred within 10 minutes of each other for approximately 91 percent and within 2 hours for more than 98 percent of the trades.

22. As discussed above, since the underlying data cannot differentiate between retail and institutional transactions, FINRA focused on customer trades of 100 bonds or less, which is intended to capture trades that are retail in nature.

23. For these calculations, dealers are identified based on unique Market Participant Identifiers (MPIDs).

24. These calculations include all customer trades where the offsetting principal trade was not a customer. For customer trades where the offsetting principal trade was also a customer, the two-way price differentials were higher. For example, the average two-way price differential was 0.85 percent for corporate debt securities and 0.65 percent for agency debt securities.

25. These results suggest that while the price differential was less than half a percent on 50 percent of these corporate debt transactions, 5 percent of the transactions had price differential of more than two percent. Similarly, for retail-sized agency debt transactions the median estimated price differential was 0.43 percent whereas the 95th percentile was 1.78 percent.

26. Consistent with the calculations for the non-complex trading scenarios, these calculations include all customer trades where the offsetting principal trades were not a customer.

27. For example, the median estimated price difference in retail-sized corporate debt transactions was 0.82 percent whereas the 95th percentile was 2.72 percent.

28. Similarly agency debt trades identified as complex scenarios were reported by 124 dealers but were concentrated among large dealers. For example, the top 20 dealers based on number of disclosure eligible trades accounted for more than 70 percent of the transactions in agency debt securities.

29. *See* Securities Exchange Act Release No. 33743 (March 9, 1994), 59 FR 12767 (March 17, 1994) (noting the functions of the transaction confirmation).

30. For example, under the mark-up disclosure approach, a non-riskless principal transaction effectuated greater than two hours apart would not be eligible to receive pricing disclosure. Similarly, firms may not use uniform approaches in calculating their mark-ups, which would reduce the comparability of this information across firms.

31. TRACE data from the first quarter of 2015 indicates that by not limiting the proposal to riskless principal trades, 38 percent more retail-size trades would have received the proposed reference price information.

32. Rule 2110(a)(4) defines an institutional investor as any "(A) person described in Rule 4512(c), regardless of whether the person has an account with a member; (B) governmental entity or subdivision thereof; (C) employee benefit plan, or multiple employee benefit plans offered to employees of the same employer, that meet the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and in the aggregate have at least 100 participants, but does not include any participant of such plans; (D) qualified plan, as defined in Section 3(a)(12)(C) of the Exchange Act, or multiple qualified plans offered to employees of the same employer, that in the aggregate have at least 100 participants, but does not include any participant of such plans; (E) member or registered person of such a member; and (F) person acting solely on behalf of any such institutional investor."

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[.];

(3) with respect to a sale to (purchase from) a non-institutional customer in a corporate or agency debt security, if 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 that equals or exceeds the size of the customer transaction:

(A) the price to the customer;

(B) the member's Reference Price;

(C) the differential between the price to the customer and the member's Reference Price; and

(D) a reference, and hyperlink if the confirmation is electronic, to the Trade Reporting And Compliance Engine (TRACE) publicly available trading data.

(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) "non-institutional customer" shall mean a customer account that is not an institutional account, as defined in Rule 4512(c).

(4) "Reference Price" shall mean the price of a same-day principal trade by the member in the same security. For purposes of establishing the Reference Price:

(A) A member is not required to consider a principal trade where:

(i) The member's principal buy (sell) transaction was executed by a trading desk that was functionally separate from the trading desk that executed the non-institutional customer order, including that the transactions and positions of the separate desk are not regularly used to source the retail transactions at the other desk;

(ii) The member's principal trade was executed with an affiliate of the member, where the affiliate's position that satisfied this trade was not acquired on the same trading day; or

(iii) The member acquired the security in a fixed-price offering and sold the security to non-institutional customers at the fixed price offering price on the day the securities were acquired.

(B) Where the member executes a principal trade that is the same size or greater than a customer trade within the same trading day in the same security, the Reference Price shall be the price of the principal trade.

(C) Where a single principal trade is not the same size or greater than the customer trade or where there are one or more intervening principal trades between the same or greater size trades within the same trading day, the member may use an alternative methodology to determine the Reference Price. Such methodology must be;

(i) an average weighted price of the member's same-day principal trades that either equal or exceed the size of the customer trade, or is derived from the price(s) of the member's same-day principal trades and communicates comparable pricing information to the customer;

(ii) consistently applied across the member's non-institutional customer base; and

(iii) clearly documented in the member's written policies and procedures.

(D) Where the member has documented and can demonstrate that there was a material change in the price of the security between the time of the transaction(s) that is (are) being used as the basis of the Reference Price and the time of the customer transaction, the member may elect not to disclose the Reference Price for that customer transaction, or may disclose the Reference Price together with a statement explaining such price change.

* * * * *

Attachment B

Guidelines For Permissible Methodologies in Establishing a Reference Price

1. Where there is a principal transaction and a customer transaction of the same size within the same trading day, or the principal transaction exceeds the size of the customer transaction and there are no intervening principal transactions, the price of the principal trade must be used.

Example:

10:00:00 AM: Firm A purchases 60 XYZ bonds from a dealer at a price of 100 for $60,000.

10:30:00 AM: Firm A sells 60 XYZ bonds to Customer 1 at a price of 101 for $60,600.

The firm must use the firm trade (100) as the reference price on the customer confirmation.

If there is an intervening principal trade, irrespective of size, the firm may use an alternative methodology for calculating the reference price.

Example: 1:1 Match with Intervening Trade

10:00:00 AM: Firm A purchases 100 XYZ bonds from a dealer at a price of 100 for $100,000.

10:30:00 AM: Firm A purchases 30 XYZ bonds from a dealer at a price of 100.50 for $30,150.

15:00:00 PM: Firm A sells 100 XYZ bonds to Customer 1 at a price of 101.50 for $101,500.

The firm is permitted to use an alternative methodology as described below.

2. Where there is not a 1:1 scenario, allow firms to calculate the reference price by a reasonable alternative methodology. We believe that a reasonable methodology could include either using the last same-day trade reported by the firm (or closest in time if reported after), or by using an average weighted price. The firm must adequately document, and consistently apply, its chosen methodology.

Example:

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 from a dealer at a price of 104.50 for $522,500.

15:00:00 PM: Firm A sells 90 XYZ bonds to Customer 1 at a price of 105.50 for $94,950.

No trades occur after the trade at 15:00:00.

The firm is permitted to use either the last firm trade (104.50), or the average weighted price (103.94).

Example:

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 from a dealer at a price of 104.50 for $522,500.

15:00:00 PM: Firm A sells 90 XYZ bonds to Customer 1 at a price of 105.50 for $94,950.

15:45:00 PM: Firm A purchases 150 XYZ bonds from a dealer a price of 105 for $157,500.

The firm is permitted to use either the last firm trade (105), which occurred after the last customer trade in this example, or the average weighted price (104.11).

3. Allow firms to either not disclose, or disclose with a disclaimer, pricing information for transactions where the firm has documented and can demonstrate that there was a material change in the price of the bond between the time of the firm and the customer transactions.

Example:

10:00:00 AM: Firm A purchases 200 XYZ bonds from a dealer at a price of 85 for $170,000.

10:30:00 AM: Due to news of an impending positive rating change, the prevailing market price for XYZ rises to 90.

13:30:00 PM: Firm A sells 100 XYZ bonds to Customer 1 at a price of 91 for $91,000.

Firms could either use the last firm trade (85) and provide explanatory language for the ensuing price change, or could decline to make pricing disclosure in this instance.

EXHIBIT 2e

Alphabetical List of Written Comments
Regulatory Notice 15-36

1. Norman L. Ashkenas, Fidelity Investments (December 16, 2015)
2. David T. Bellaire, Financial Services Institute (December 11, 2015)
3. David P. Bergers, LPL Financial, LLC (December 10, 2015)
4. Hugh D. Berkson, Public Investors Arbitration Bar Association (December 8, 2015)
5. Jason Clague, Charles Schwab & Co., Inc. (December 11, 2015)
6. Sean Davy, Securities Industry and Financial Markets Association (December 11, 2015)
7. Elizabeth Dennis, Morgan Stanley Smith Barney LLC (December 11, 2015)
8. Herbert Diamant, Diamant Investment Corporation (November 30, 2015)
9. Rick A. Fleming, Securities and Exchange Commission (December 11, 2015)
10. Micha Hauptman, Consumer Federation of America (December 11, 2015)
11. Manisha Kimmel, Thomson Reuters (December 11, 2015)
12. Robert J. McCarthy, Wells Fargo Advisors, LLC (December 11, 2015)
13. Chris Melton, Coastal Securities (December 11, 2015)
14. Michael Nicholas, Bond Dealers of America (December 11, 2015)
15. Paige Pierce, RW Smith & Associates, LLC (December 14, 2015)
16. Kurt N. Schacht, CFA Institute (December 11, 2015)
17. Thomas S. Vales, TMC Bonds LLC (December 11, 2015)
18. Darren Wasney, Financial Information Forum (December 11, 2015)

December 11, 2015

Submitted electronically

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: **FINRA Regulatory Notice 15-36,**
Pricing Disclosure in the Fixed Income Markets

MSRB Regulatory Notice 2015-16,
Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-Ups for Specified Principal Transactions with Retail Customers

Dear Ms. Asquith and Mr. Smith:

Fidelity Investments[1] ("Fidelity") appreciates the opportunity to respond to the Financial Industry Regulatory Authority's ("FINRA's") Regulatory Notice 15-36 and the Municipal Securities Rulemaking Board's ("MSRB's") Regulatory Notice 2015-16 (together the "Proposals").[2] The Proposals seek to enhance fixed income pricing transparency for retail customers by generally requiring brokers, dealers and municipal security dealers ("broker-dealers") to disclose, on retail customer confirmation statements, the price to the customer, the price to the broker-dealer, and the differential between those two prices for certain principal transactions in corporate, agency and municipal securities. FINRA and the MSRB obtained initial views on the Proposals in FINRA Regulatory Notice 14-52 and MSRB Regulatory Notice 2014-20[3] (the "initial Proposals") on which Fidelity provided comments.[4]

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[1]Fidelity is one of the world's largest providers of financial services. Fidelity provides investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 20 million individuals and institutions, as well as through 10,000 financial intermediary firms.

[2]*See* FINRA Regulatory Notice 15-36; Pricing Disclosure in the Fixed Income Markets (October 2015) *available at:* http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-15-36.pdf ("FINRA Proposal") *See* MSRB Regulatory Notice 2015-16; Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations (September, 2015) *available at:* http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2015-16.ashx?la=en ("MSRB Proposal"). Unless otherwise defined in this letter, capitalized terms have the meanings ascribed to them in the Proposals.

[3]*See* FINRA Regulatory Notice 14-52; Pricing Disclosure in the Fixed Income Markets (November 2014) *available at:* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p601685.pdf and *See* MSRB Regulatory Notice 2014-20; Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations (November 2014) *available at:* http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-20.ashx?n=1

Fidelity submits this letter on behalf of Fidelity Brokerage Services LLC ("FBS"), a Securities and Exchange Commission ("SEC") registered introducing retail broker-dealer and FINRA member, and its affiliate, National Financial Services LLC ("NFS"), a SEC registered clearing firm and FINRA member. Both FBS and NFS are registered with the MSRB as municipal securities dealers. Fidelity's comments reflect the views of both an introducing broker-dealer and a clearing broker-dealer that will be affected by the Proposals.

As we discussed in our comments on the initial Proposals, Fidelity supports targeted, market-driven, pricing transparency efforts in the fixed income markets. Pricing transparency promotes robust competition among diverse market participants, which helps foster innovation and allows for greater customer choice.

Fidelity's pricing model for our self-directed retail brokerage customers demonstrates our commitment to transparent, simple and low cost fixed income pricing. Fidelity provides its retail brokerage customers access to a wide selection of secondary market fixed income inventory sourced directly from third-party alternative trading systems (Tradeweb Direct, KCG Bondpoint and TMC Bonds), other national broker-dealers, and from its affiliate, Fidelity Capital Markets (FCM), a division of NFS. Bonds from FCM are treated on a par with fixed income security offerings from unaffiliated third-party sources. When FCM is not the offering dealer, Fidelity's compensation is limited to a fully disclosed bond trading fee of $1 per bond online.[5] We disclose this fee prior to the trade, in our retail brokerage commission schedule, on order preview pages at the point of trade on *Fidelity.com*, and via representatives in representative-assisted trades.

We believe that a reasonably disclosed, fixed, bond transaction fee is a more transparent form of pricing for retail brokerage customers than mark-up based pricing and, in many cases, is more cost efficient. Fidelity recently commissioned Corporate Insight to study bond pricing, available online, for self-directed retail investors from five brokers that offer corporate and municipal bonds. The study found on average that three competitors that bundled their markups or fees into their online bond prices were asking an average of $13.97 more per bond than Fidelity.[6]

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[4]Fidelity comment letter available at: http://www.finra.org/sites/default/files/notice_comment_file_ref/Fidelity_Investments_FINRA_RN14-52.pdf and http://www.msrb.org/RFC/2014-20/Fidelity.pdf

[5]Minimum concessions apply: online secondary market transactions $8; if traded with a Fidelity representative, $19.95. For U.S. Treasury auction purchases traded with a Fidelity representative, $19.95 per trade. Fixed income trading requires a Fidelity brokerage account with a minimum opening balance of $2,500. Rates are for U.S. dollar–denominated bonds; additional fees and minimums apply for non-dollar bond trades. Other conditions may apply. See Fidelity.com/commissions for details.

[6]The study compared online bond prices for over 20,000 municipal and corporate inventory matches between September 2 and October 6, 2015. It compared municipal and corporate inventories offered online in quantities of at least $10,000 face or par value. Corporate Insight determined the average cost differential by calculating the difference between the costs of matching corporate and municipal bond inventory at Fidelity vs. the markup-based firms in the study, then averaging the differences across all of the competitor firms. For further information regarding this study, see *Are Investors Getting the Biggest Bang for Their Brokerage Buck? Fidelity Investments Value Survey Reveals Comparison Shopping Can Have a Major Impact on Investor's Wallets* (November 24, 2015) *available at:* https://www.fidelity.com/about-fidelity/individual-investing/investors-getting-biggest-bang-for-buck

Fidelity appreciates regulatory efforts to improve pricing transparency in the fixed income markets. We acknowledge the deliberative approach FINRA and the MSRB have taken with respect to the Proposals and their efforts to gather thoughtful and detailed feedback through comment letters and interactive sessions with member firms. While FINRA and the MSRB have made several modifications to the initial Proposals, we continue to have significant concerns with the Proposals as currently drafted. These concerns focus on the following areas:

- *The Proposals are not harmonized.* To increase retail customer understanding and to acknowledge efficiencies in market regulation of similar products, FINRA and MSRB confirmation mark-up requirements for principal transactions must be uniform in design and operation;

- *The Proposals should apply to a broader group of principal transactions and focus on the difference between the price the customer was charged and the prevailing market price ("PMP") of the security. PMP should be defined differently in different trading scenarios.* To increase retail customer understanding of the fairness and reasonableness of fixed income pricing, mark-up disclosure requirements should 1) apply to all fixed income transactions executed on a principal basis; 2) be determined contemporaneously with trade execution; and 3) focus on the difference between the price the customer was charged and the PMP of the security. PMP should be defined differently in different trading situations; and

- *The current Proposals remain unworkable from a market participant standpoint.* Changes to the Proposals, as currently drafted, are critical because the Proposals would introduce new operational risks into the already complex confirmation statement generation process.

Each of these points in discussed in further detail below.

<u>The FINRA and MSRB Proposals Must Be Harmonized.</u>

As currently drafted, there are material and substantive differences between the Proposals. For example, the Proposals contain different disclosure requirements[7], differences in the time window for evaluating trades[8], different descriptions of transactions executed by a "functionally separate trading desk"[9], different requirements regarding how positions acquired

[7]The MSRB Proposal requires, for retail and institutional accounts, the time of trade execution accurate to the nearest minute and for retail accounts only, a hyperlink and URL address to the Securities' Details page for the customer's security on EMMA along with a brief description of the type of information available on that page while the FINRA Proposal requires for retail customer accounts only a reference, and hyperlink if the confirmation is electric, to TRACE publically available data.

[8]The MSRB Proposal contemplates a two hour look forward and look-back for applicable trades and seeks comment on its initial Proposal that required a full day look-back, while the FINRA Proposal requires a full day look-back.

[9]Under the MSRB Proposal, where multiple trading desks under a single dealer operate independently such that one trading desk may have no knowledge of the transactions executed by another trading desk, mark-up disclosure would not be required for a customer transaction if the dealer can establish that: the customer transaction was executed by a principal trading desk that is functionally separate from the principal trading desk that executed the

by an affiliate would be excluded from the proposed requirements[10] as well as different approaches to new issues[11], and material changes in the price of a security.[12] Most significantly, there are fundamental differences in the Proposals with regard to how a dealer's mark-up or mark-down would be calculated and presented to retail customers on their confirmation statement.[13]

We acknowledge FINRA and the MSRB's challenge to design rules that are consistent and address regulatory concerns across the corporate, agency and municipal securities fixed-income markets, but believe that retail investors and market participants would be well served by a coordinated regulatory approach that results in requirements that are uniform in design and operation. To this end, we anticipate that a coordinated approach to rulemaking would include not only the resolution of material and substantive differences between the FINRA Proposal and

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dealer's same-side of the market transaction; and the functionally separate principal trading desk through which such same-side of the market transaction was executed had no knowledge of the retail customer transaction. In contrast, FINRA proposes to exclude firm-side transactions from the proposed disclosure that are conducted by a department or desk that is functionally separate from the retail-side desk, *e.g.*, where the firm can demonstrate through policies and procedures that the firm-side transaction was made by an institutional desk for an institutional customer that is separate from the retail desk and the retail customer. This exception would not apply, however, where the transaction of the separate department or desk is related to the other desk, *e.g.*, if the transactions and positions of a separate department or desk are regularly used to source the retail transactions at the other desk.

[10]Under the MSRB Proposal, if a municipal securities dealer, on an exclusive basis, acquires municipal securities from [sells to] an affiliate that holds inventory in such securities and transacts with other market participants, the dealer would be required to "look through" the transaction with the affiliated dealer and substitute the affiliates trade with the third party from whom it purchased or to whom it sold the security to determine whether disclosure of the mark-up would be required. FINRA proposes to exclude trades where the member's principal trade was executed with an affiliate of the member and the affiliate's position that satisfied this trade was not acquired on the same trading day.

[11]The MSRB Proposal would not require disclosure for transactions in new issue securities affected at the list offering price by members of the underwriters group. FINRA's Proposal would not require disclosure where the member acquired the security in a fixed-price offering and sold the security to non-institutional customers at the fixed price offering price on the day the securities were acquired and the proposal would continue to apply to new issue transactions that are part of variable price offerings.

[12]FINRA proposes that in the event of a material change in the price of a security between the time of the firm principal trade and the customer trade, the reference price may be omitted from the confirm. The MSRB Proposal contains no similar exclusion, although a material change in the price of a security would presumably also affect the prevailing market price.

[13]The MSRB Proposal would require confirmation disclosure of mark-ups for certain principal transactions with retail customers when the dealer makes a corresponding trade within two hours before or after the customer's trade. The MSRB has also requested comment on proposed modifications to a November 2014 proposal that would require confirmation disclosure of same-day pricing information for specified principal transactions with retail customers. Under the MSRB' Proposal, a dealer's mark-up would be disclosed as total dollar amount and as a percentage of the principal amount of the customer transactions and the mark-up to be disclosed would be the difference between the price to the customer and the prevailing market price of the security where presumptively the prevailing market price would be established by looking at the dealer's contemporaneous costs. The FINRA Proposal would require confirmation disclosure of same-day pricing information for specified principal transactions with retail customers. Under the FINRA Proposal, the dealer would be required to disclose the price to the customer, the members Reference Price and the differential between the price the customer and the member's Reference Price where the Reference Price is defined as the price of the dealer's principal trade. The FINRA Proposal also allows for firms to use alternative methodologies to calculate the Reference Price in a complex Trade Scenario while the MSRB Proposal contains no similar provision.

MSRB Proposal but also the use of identical language where the regulatory requirements are ostensibly the same.

The use of different wording to accomplish the same regulatory goal can lead to reasonable assumptions that regulatory requirements differ. If different wording is used in the FINRA Proposal and MSRB Proposal to meet identical requirements, we are concerned that MSRB and FINRA examination and enforcement staff will interpret the different wording to mean different things, otherwise, one might reasonably ask, why wasn't the same wording used across both Proposals? Moreover, if different wording is used to accomplish the same regulatory goals, industry participants will be called upon to harmonize the FINRA and MSRB final rules in practice, which is not an appropriate or efficient use of industry resources. To the extent that FINRA and the MSRB are not able to harmonize their approach to final rulemaking on this topic, we urge the SEC to take action.

Moreover, as FINRA and the MSRB are aware, the Department of Labor is currently engaged in rulemaking that would require disclosure of dealer mark-ups, among other items, in certain fixed income transactions executed as principal in connection with the provision of investment advice to retirement accounts.[14] Fidelity has urged the Department of Labor to allow FINRA and the MSRB to take the lead in rulemaking on this topic, as FINRA and MSRB rules will apply across retirement and non-retirement accounts.[15]

It appears that the Department of Labor's final rule on disclosure of dealer mark-ups may precede any FINRA and MSRB final rulemaking. While we are hopeful that the DOL will recognize and leverage the work by FINRA and the MSRB, the potential conflict and investor confusion from potentially three different sets of mark-up disclosure requirements highlights the importance of FINRA and the MSRB adopting a uniform rule.

<u>Fixed income mark-up disclosure should 1) apply to all fixed income transactions executed on a principal basis; 2) be determined contemporaneously with trade execution; and 3) be based on the prevailing market price ("PMP") of the security, with the PMP determined by the circumstances of the trade.</u>

The Proposals seek to ensure fairness and transparency around mark-ups in fixed income transactions by requiring broker-dealers to provide mark-up disclosure on a subset of retail customer fixed income transactions executed on a principal basis. Depending on when a broker-dealer makes a corresponding principal trade to a customer's trade (i.e. within two hours, before or after, the customer's trade or on the same day as the customer's trade) the proposed mark-up disclosure may --or may not-- appear on the customer's confirmation statement. As a result,

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[14] *Definition of the Term "Fiduciary", Conflicts of Interest Rule – Retirement Investment Advice*; *Proposed Rule* 80 FR 21928 (April 20, 2015); *Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs* 80 FR 21989 (April 20, 2015)

[15] *See* Letter from Ralph Derbyshire, Senior Vice President & Deputy General Counsel, FMR LLC Legal Department, to Office of Regulations and Interpretations, Employee Benefits Security Administration, (July 21, 2015) *available at*: http://www.dol.gov/ebsa/pdf/1210-AB32-2-00658.pdf

within a single confirmation statement, mark-up disclosure may appear for some --but not other-- fixed income securities where the firm has executed the transaction on a principal basis. We believe that the limited scope of the Proposals will do little to clarify fixed income pricing for retail customers.[16] Moreover, a requirement for dealers to complete an end-of-day review of all dealer transactions that occur within a two-hour window before or after the customer transaction, or on the same day as the customer transaction, will pose risks to the process used by dealers to generate customer confirmation statements.[17]

In place of the current Proposals, FINRA and the MSRB should require *real-time* mark-up disclosure across *all* fixed income transactions executed on a principal basis, subject to the methodology we propose. A uniform disclosure requirement across all fixed income securities executed on a principal basis would:

- reduce retail customer confusion as to why this disclosure appears on some --but not all -- of their fixed income transactions where the firm acts in a principal capacity;

- avoid broker-dealers having to navigate an overly complex and at time conflicting trade matching process that invites new operational risk in the already complex confirmation statement generation process; and

- eliminate regulatory concerns with gaming by removing an artificial boundary beyond which disclosure is not required.

Additionally, we question the ultimate regulatory goal of mark-up disclosure in fixed income transactions executed on a principal basis. If the ultimate regulatory goal is to require mark-up disclosure across all fixed income transactions executed on a principal basis, an interim requirement to apply disclosure to a limited subset of trades will re-direct and reduce industry resources and confuse retail customers. Disclosure requirements that apply to all fixed income transactions executed on a principal basis would make more efficient use of limited industry and regulatory resources and promote retail investor understanding. We urge FINRA and the MSRB to consider the strategic and long term view of this approach.

Proposed Mark-Up Disclosure Methodology.

FINRA and the MSRB's mark-up disclosure requirements should focus on the difference between the price the customer was charged for a fixed income security and the PMP of the fixed income security. We acknowledge the regulatory challenge in defining PMP in the fixed income markets. Unlike the equities markets that define PMP by the National Best Bid or Offer ("NBBO"), the fixed income markets do not have a real time valuation or market wide best price

[16]Retail customers currently receive dealer compensation information for trades executed on an agency basis. Under the Proposals, retail customers would receive dealer compensation information for a subset of principal trades and would receive no dealer compensation information for other principal trades. We believe that a third scenario (no disclosure based on the time of the corresponding principal trade) will lead to customer confusion and not add to customer understanding of the fairness and reasonableness of dealer compensation.
[17]*See* discussion infra at page 9.

for each fixed income security. This issue is compounded by the fact that many fixed income securities do not have a ready market.

The Proposals seek to provide retail customers information on whether they received a fair price on their fixed income trade by comparing the price the dealer paid for the fixed income security with the price at which the dealer sold the fixed income security - that is the dealer's profit and loss on the trade - in transactions where a dealer's trade occurs on the same side of the market as the customer's trade, either on the same day or within a two hour window. For example, under the MSRB Proposal, a dealer would be required to show the difference between the price to the customer and the PMP for the security, with the PMP established by referring to the dealer's contemporaneous costs incurred or contemporaneous proceeds obtained. For the FINRA Proposal, the price to the customer would be compared to the Reference Price, defined as the price of the principal trade.

We agree that there are situations in which a dealer's actual contemporaneous costs or proceeds are a reasonable proxy for PMP. For example, we believe that this approach would work well in the case of certain "riskless principal" transactions where, after receiving an order to buy from a customer, a dealer purchases a security from another person to offset a contemporaneous sale to such customer, or, having received an order to sell from a customer, the dealer sells the security to another person to offset a contemporaneous purchase from such customer.

We also see many situations in which a dealer's costs or proceeds are not a reasonable proxy for PMP, such as where the dealer executes a trade from inventory or where there have been significant events affecting the price of the security since it was bought or sold. In these situations, the price a dealer paid for a fixed income security is a less reliable indication of fair price for retail customers based on the many different factors that can affect a dealer's profit and loss on a fixed income transaction. These factors include, but are not limited to, market events, security specific news events and length of time in inventory.

Moreover, dealer profit and loss is not how consumers typically judge fair pricing. Fair pricing is generally determined to be the price paid for a product at a given vendor versus the PMP across the industry. For example, if a consumer goes to a particular grocery store to purchase a can of soup, the price the grocery store paid their vendor for the can of soup is not relevant to the consumer's decision to purchase the can of soup at that particular store. Instead, the consumer generally determines the fairness of their purchase price by understanding the price other grocery stores charge for the can of soup and making a determination to purchase the can of soup at a particular store based off this comparison.

While a number of different alternative definitions are possible and warrant further discussion, we propose PMP be defined as the dealer's best available price for the subject security under the best available market at the time of trade execution. Because there is no single, objective standard for best available price for a particular security, regulators should consider providing detailed interpretive guidance or best practices to assist dealers in determining the PMP for a fixed income security in these situations. These industry best

practices might include several different methodologies that dealers could apply when determining PMP including but not limited to, looking at a trader's mark-to-market at the end of the day, contemporaneous cost, top of book, and/or vendor solutions that offer real time valuations for certain securities.[18] Firms would employ a reasonable methodology and clearly document and consistently apply their chosen methodology. We believe that this real-time approach to mark-up disclosure, combined with existing dealer obligations of best execution and fair and reasonable compensation, will be understandable to retail investors and provide needed flexibility to market participants.

A comparison of the cost of a customer's fixed income transaction at a specific firm to the PMP, combined with a link to real-time EMMA or TRACE data regarding the specific fixed income security, would provide retail customers both dealer specific and industry information concerning their individual trade. Moreover, this combined approach sends a strong regulatory message that mark-up disclosure is an important component of a retail customers' trade across ***all*** fixed income transactions, not a limited subset of trades. We would anticipate that this information would be provided by introducing firms to their clearing firm during the normal trade process, minimizing disruption to the trade confirmation process. Because the disclosure would be required across all retail fixed income trades, not a subset of trades, this approach would also seek to minimize regulatory gaming concerns.

We believe that using a PMP to calculate a reference price on a fixed income security is a more tailored and more transparent approach than certain alternative proposals such as a Volume Weighted Daily Average Price ("VWAP") or a Volume Weighted Daily Average Spread ("VWAS") calculated by regulators or individual dealers. FINRA's analysis of estimated mark-ups and mark-downs on customer trades in corporate and agency debt securities during the first quarter of 2015 showed a material difference between the median mark-ups and mark-downs at the tail of the distribution, indicating that some customers paid considerably more than others in similar trades.[19] A proposed VWAP or VWAS approach does not address the issue of fairness or reasonableness of dealer compensation because it does not provide trade specific information to investors which would highlight dealer prices significantly higher than others in the industry. The approach also presents significant operational difficulties in that if regulators or dealers were to calculate a VWAP or VWAS for each security after the end of each trading day, the process a broker-dealer uses to generate confirmation statements for retail investors could be delayed.

If FINRA and the MSRB seek to improve fixed income price transparency for retail investors, we believe that 1) a comparison of the cost of a fixed income transaction at a specific firm to the PMP (under our proposed methodology) combined with 2) a link to real-time EMMA or TRACE data regarding the specific fixed income security would address this regulatory goal. Nevertheless, given the possibility that our views may not prevail, we are compelled to once

[18]For example, MSRB Notice 2010-10 (April 21, 2010) requested comment on draft interpretive guidance on prevailing market prices and mark-up for transactions in municipal securities. We believe that this draft guidance provides a good starting point for future interpretive guidance on prevailing market price for purposes of mark-up disclosures for both the MSRB and FINRA. MSRB Notice *available at:* http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2010/2010-10.aspx

[19]FINRA Proposal at page 7.

again raise our significant concerns with the current Proposals from a market participant standpoint.

The Proposals As Currently Drafted Are Not Workable For Market Participants.

The Proposals, as currently drafted, would add significant operational challenges to the confirmation statement process by adding new layers and requirements onto already complex systems. Moreover, to the extent that the Proposals require disclosure that cannot be added to the trade record at the same time as the trade execution, the Proposals create risks to the confirmation statement process.

Notably, the Proposals would require broker-dealers to build a significant new system, at considerable cost, to match trades that meet certain time requirements transaction. By necessity, this system, at the end of the business day, will need to identify all possible matching scenarios for all principal fixed income transactions over the course of the specified time period and navigate an overly complicated – and at times conflicting – matching methodology. The application of these methodologies to situations where there is significant buying and selling activity at varying prices, varying sizes, and across varying business channels can quickly become quite complex.

The operational challenges of the Proposals are especially significant for clearing broker-dealers that would likely be required to coordinate and rely on third parties for data necessary for compliance.

Fully-disclosed clearing broker-dealers clear and settle millions of securities transactions each day for thousands of introducing broker-dealers.[20] Clearing broker-dealers do not sell securities to retail customers. Rather, a fully-disclosed clearing broker-dealer provides routine and ministerial "back office" processing services -- clearance and settlement and custody services -- to introducing broker-dealers. The relationship between the clearing broker-dealer and the introducing broker-dealer and the division of responsibilities between them is set forth in a fully disclosed clearing agreement, which is filed with and approved by FINRA before any clearing services may begin.

Among other back-office functions, clearing broker-dealers settle fixed income trades and print and mail end-customer confirmation statements for introducing broker-dealers. With considerable effort involving the review of multiple principal accounts across all of its introducing broker-dealers, a clearing broker-dealer could likely obtain access to the underlying details of when, how, or for how much the introducing broker-dealer obtained the fixed income security it ultimately sold to its end-customer. More likely, an introducing broker-dealer would need to submit information on a particular trade to its clearing broker-dealer at the end of the business day, after the introducing broker-dealer has determined this information itself.

[20]Because many introducing broker-dealers (aka "correspondents") do not have the net capital, resources, technology, personnel or expertise to clear and settle their own trades, introducing broker-dealers often contract with a third-party clearing broker-dealers to carry their proprietary accounts (if any) and its end-customer accounts and perform back office functions on a fully-disclosed basis (*i.e.*, disclosed to the introducing firm's end customers).

Requiring matched trade information with a full day "look back" conflicts with how trade confirmation statements are processed today, increasing the risk that they will not be completed within regulatory timeframes.[21] Standard industry processing of retail customer trade confirmations involves batching and pricing during the day, processing immediately after market close, overnight composing, with printing and mailing the next business day. For example, at most clearing broker-dealers:

- During the business day, trading occurs in multiple channels throughout the organization and information on these trades moves throughout the day, in real time, to a single "trade prep" location;
- At this location, among other items, calculations are performed and consolidation work is done on the underlying data used to populate the trade confirmation;
- At market close, a file is sent from the "trade prep" location to a trade confirmation engine where the data is formatted and the trade confirmation is composed. This step typically takes place in the 10pm to 2am time window; and
- After the trade confirmation is composed, next steps include, but are not limited to, monitoring, paper fulfillment, or electronic fulfillment.

If the Proposals are approved as currently drafted, at the end of each business day, introducing broker-dealers will need to sift through all of their customer fixed income transaction data for the day to identify and isolate (i) which trades, out of the larger universe of customers trades executed that day, are subject to the disclosure requirements (ii) the price to the introducing broker-dealer of the fixed income security under several different complex methodologies and (iii) mark-up information on the trade, as applicable.

The introducing broker-dealer would then need to transmit this information to its clearing broker-dealer, who would be required to (i) identify the relevant trade out of the broader universe of trades for that day; (ii) pass this information to their trade confirmation engine; and (iii) update the particular trade file in the trade confirmation engine. All of this work would need to be performed, without error or delay, before the established deadlines for passing files to the trade confirmation engine to allow the clearing broker-dealer to print and mail the statement to the end-customer within established regulatory timeframes.

We believe that the current industry practice of processing of trades throughout the business day serves important risk mitigation purposes. Straight-through processing of trade confirmations provides transparency to fixed income trading that helps broker-dealers' risk management practices. The processing of trades throughout the business day also helps avoid bottlenecks that may affect the timely, accurate, and complete processing of retail customer trade confirmation statements.

[21]From an operational standpoint, we do not see a two hour look-forward/look-back, as the MSRB has proposed, to be different from a full day look back (as FINRA proposes and as the MSRB previously proposed). In both cases a full trading day worth of data must be captured and reviewed at the end of the trading day in order to match certain trades for disclosure purposes.

The Proposals place significant time pressure on the confirmation statement process, particularly in light of current initiatives to shorten the settlement cycle. Exchange Act Rule 10b-10, FINRA Rule 2230 and MSRB Rule G-15 generally require broker-dealers that effect transactions in the account of a customer to provide a confirmation to the customer "at or before the completion of" such transaction. Exchange Act Rule 15c1-1(b) defines "the completion of the transaction" to be, generally, when the customer makes payment to the broker, or when the broker delivers the security to the account of the customer.

As both FINRA and the MSRB are aware, the Depository Trust & Clearing Corporation ("DTCC") is currently leading an industry effort to shorten the U.S. trade settlement cycle for equities, municipal and corporate fixed income bonds, and unit investment trusts ("UITs") from T+3 (trade date plus three days) to T+2 (trade date plus two days).[22] SEC Commissioners Piwowar and Stein have expressed support for the move to T+2 along with SEC Chair Mary Jo White.[23] Moreover, the MSRB has published a request for comment on changes to MSRB Rules to facilitate shortening the securities settlement cycle.[24]

The tension between the Proposals' greater disclosure requirements, which can only be accessed and added to trade confirmation statements at the end of the day, and a shorter settlement cycle, adds complexity and operational risk to the trade confirmation statement process and is a further reason why we believe the Proposals should be withdrawn and alternatives considered.

Certain Aspects of the Proposals Must Be Clarified.

If the Proposals proceed in their current form, certain aspects must be clarified prior to final rulemaking.

Affiliates

Under the MSRB's Proposal, if a municipal securities dealer, on an exclusive basis, acquires municipal securities from [sells to] an affiliate that holds inventory in such securities and transacts with other market participants, the dealer would be required to "look through" the transaction with the affiliated dealer and substitute the affiliates trade with the third party from whom it purchased or to whom it sold the security to determine whether disclosure of the mark-up would be required. In contrast, FINRA proposes to exclude trades where the member's

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[22]Depository Trust & Clearing Corporation, DTCC Recommends Shortening the U.S. Trade Settlement Cycle, April 2014 (advocating for a move to a two-day settlement period).

[23] Commissioners Michael S. Piwowar and Kara M. Stein, Public Statement Regarding Proposals to Shorten the Trade Settlement Cycle (June 29, 2015) *available at*: http://www.sec.gov/news/statement/statement-on-proposals-to-shorten-the-trade-settlement-cycle.html and Letter from Mary Jo White, Chair, Securities and Exchange Commission, to Kenneth E. Bentsen, Jr., President and CEO, Securities Industry and Financial Markets Association, and Paul Schott Stevens, President and CEO, Investment Company Institute (September 16, 2015).

[24]MSRB Regulatory Notice 2015-22 Request for Comment on Changes to MSRB Rules to Facilitate Shortening the Securities Settlement Cycle (November 10, 2015) *available at*: http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2015-22.ashx?la=en

principal trade was executed with an affiliate of the member and the affiliate's position that satisfied this trade was not acquired on the same trading day.

To increase retail customer understanding and to acknowledge efficiencies in market regulation for similar products, FINRA and MSRB confirmation mark-up requirements for principal transactions must be uniform in design and operation. Of the two proposals, we encourage FINRA and the MSRB to follow the MSRB's approach to affiliated dealer trades, which we consider a better approach for retail investors and market participants. If a dealer provides its customers access to a wide selection of secondary market fixed income inventory from multiple sources, the fact that an affiliated dealer is included and treated on par with these sources should not raise regulatory concern. Moreover, as long as the affiliate pricing is competitive with the other sources, the use of an affiliate to the dealer to source the trade should not impact retail customers who ultimately would obtain the best price available for their security.

Use of Standard Mark-up Schedules in lieu of Proposed Disclosure

Certain broker-dealers establish and make available to retail customers schedules of standard charges for fixed income security transactions. To help encourage transparency in fixed income pricing, FINRA and the MSRB should permit broker-dealers to use standard mark-up schedules in place of the proposed mark-up disclosure requirements on retail customer confirmation statements. Standard mark-up schedule disclosure could be conveyed to retail customers via a link to the schedule on the confirmation statement or via annual mailed disclosure in place of the confirmation statement disclosure contemplated by the Proposals. This information would be helpful to retail investors and provide an alternative approach to market participants. Moreover, this approach does not raise operational issues associated with the current Proposals.

Changes to the PMP Should Not Require a New Confirmation Statement

FINRA and the MSRB should clearly state in any final rule that a dealer is permitted, but not required, to resend confirmation statements due solely to a change in the PMP or the differential between the customer price and the PMP. FINRA and the MSRB should also clearly state in any final rule that dealers would expressly be permitted to include a disclaimer on the customer confirmation that the PMP and related differential were determined as of the time of confirmation generation. Among other reasons, from an operational standpoint, in order to resend the confirmation statement, the broker-dealer may need to cancel and rebill the customer's trade to reflect the new reference price. This requirement may contribute to a firm's late trade reporting if such cancel and rebill of the customer trade would be required to be trade reported.

Implementation Timeframe and Cost of Proposals

FINRA and the MSRB have proposed several different methods by which dealers could calculate the proposed mark-up disclosure. Industry participants have similarly proposed

alternative methods for this calculation. At this point in time, it is not clear to us which approach will ultimately be taken. We are happy to provide cost estimates on specific aspects of the Proposals once further granularity on the regulatory approach to be taken is available. Similarly, because the time required to comply with the Proposals will depend on the complexity of any final rule, as well as other rules that dealers are asked to implement contemporaneously, we ask FINRA and the MSRB to work with the industry on a proposed implementation timeframe that is responsive to industry needs.

* * * * *

Fidelity thanks FINRA and the MSRB for considering our comments. We would be pleased to provide any further information and respond to any questions that you may have.

Sincerely,

Norman L. Ashkenas
Chief Compliance Officer
Fidelity Brokerage Services, LLC

Richard J. O'Brien
Chief Compliance Officer
National Financial Services, LLC

cc:

Mr. Richard Ketchum, Chairman and Chief Executive Officer, FINRA
Ms. Susan Axelrod, Executive Vice President, Regulatory Operations, FINRA
Mr. Robert Colby, Chief Legal Officer, FINRA

Ms. Lynette Kelly, Executive Director, MSRB
Mr. John A. Bagley, Chief Market Structure Officer, MSRB
Mr. Michael L. Post, Deputy General Counsel, MSRB

Mr. Stephen Luparello, Director, Division of Trading and Markets, SEC
Mr. Gary Goldsholle, Deputy Director, Division of Trading and Markets, SEC
Mr. David Shillman, Associate Director, Division of Trading and Markets, SEC
Ms. Jessica S. Kane, Deputy Director, Office of Municipal Securities, SEC

FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

December 11, 2015

Marcia E. Asquith
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FINRA
1735 K Street, NW
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Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
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Alexandria, VA 22314

Re: **FINRA Regulatory Notice 15-36: Pricing Disclosure in the Fixed Income Markets**

MSRB Regulatory Notice 2015-16: Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers

Dear Ms. Asquith and Mr. Smith:

On September 24, 2015 the Municipal Securities Rulemaking Board (MSRB) published Regulatory Notice 2015-16 requesting public comment on proposed recommendations to require confirmation disclosure of mark-ups for specified principal transactions with retail customers.[1] On October 15, 2015 the Financial Industry Regulatory Authority (FINRA) published Regulatory Notice 15-36 requesting public comment on a revised proposal requiring confirmation disclosure of pricing information in corporate and agency debt securities transactions.[2] Both requests represent revised versions of proposals issued for public comment by both self-regulatory organizations (SROs) in November 2014.[3]

The Financial Services Institute[4] (FSI) appreciates the opportunity to comment on these important proposals. We strongly support regulatory actions designed to enhance bond market pricing transparency for retail investors. As we noted in our prior comment letters, we believe that retail investors should have access to timely and complete information regarding fixed income securities to make informed investment decisions. However, we have concerns that the proposals under consideration may detrimentally impact the ability of small firms to service retail bond investors. We respectfully request that FINRA and the MSRB work with the industry to develop a

[1] Regulatory Notice 2015-16, Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers (Sept. 24, 2015) (MSRB Regulatory Notice).
[2] Regulatory Notice 15-36, Pricing Disclosure in Fixed Income Markets (Oct. 15, 2015) (FINRA Regulatory Notice).
[3] Regulatory Notice 2014-20, Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations (Nov. 17, 2014); Regulatory Notice 14-52, Pricing Disclosure in the Fixed Income Markets (Nov. 17, 2014).
[4] 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.

joint proposal that achieves its desired goals of ensuring investors have clear understanding of their transactions costs and allows investors to benefit from market competition.

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

Collectively, FINRA and the MSRB request comments on three different pricing disclosure proposals. First, FINRA requests comment on revisions to its matched-trading proposal issued for comment in 2014. Second, both FINRA and the MSRB request comment on an MSRB proposal to require the disclosure of the mark-up or mark-down from the prevailing market price of a security if the firm traded with a retail customer within a two hour time period. Third, the MSRB requests comments on amendments to its matched-trading proposal issued for comment in 2014. We are concerned that each of the proposals under consideration would materially alter the competitive landscape to the detriment of small firms. Additionally, such proposals may result in greater investor confusion. Lastly, we are concerned that should FINRA and the MSRB choose to pursue an incremental approach to pricing disclosure, firms will face materially higher operational and technology expenses. As such, we request FINRA and the MSRB work with stakeholders on a comprehensive pricing disclosure proposal.

In pursuing such a comprehensive pricing disclosure proposal, or any pricing disclosure proposal, we wish to highlight the following items for consideration:

- The disclosure should be based on the prevailing market price for the customer's security;
- The disclosure should leverage existing transparency platforms by requiring the inclusion of links to TRACE and EMMA homepages as well as the time of execution of customer trades on confirmations;
- FINRA and the MSRB should create good faith errors safe harbors for inadvertent mistakes on confirmations; and
- FINRA and the MSRB should undertake initiatives to educate investors on fixed income market structure and the sources of dealer costs in executing trades.

I. FINRA and the MSRB Should Work on a Coordinated Comprehensive Pricing Disclosure Proposal that Preserves the Competitive Landscape

A. Introduction

The proposals raise concerns regarding potential disproportionate impacts on small dealers that ultimately will result in less choice for investors. Regardless of whether pricing disclosure applies to trades within a two-hour time period, or the same day, the proposed disclosure requirements will capture the overwhelming majority, if not the entirety, of transactions executed by smaller dealers, particularly fully-disclosed introducing firms. These dealers do not possess the necessary capital to maintain inventory for a significant time period. We are concerned that mandating disclosure for these transactions may result in the creation of competitive imbalances that will ultimately harm smaller firms to a greater extent than larger dealers and confuse investors seeking to make pricing comparisons across firms of various sizes and models.

In light of the potential detrimental impacts that will be predominantly borne by small firms, we respectfully request that prior to further pursuing rulemaking in this area, FINRA and the MSRB consult with industry stakeholders regarding the entirety of their intentions for fixed income pricing disclosure. We recognize that both FINRA and the MSRB might consider additional bond market pricing transparency initiatives in the future. Such additional measures might capture a larger universe of principal transactions. Understanding the potential for future disclosure requirements will allow regulators and the industry to work together on developing a single comprehensive proposal for providing retail investors with enhanced pricing information. This approach will limit the adverse impacts on small dealers and will ensure that firms are not required to overhaul or rebuild systems shortly after coming into compliance with one of the proposals for which comments are requested.

B. Burdens on Competition

Both FINRA and the MSRB discuss the potential for the proposals to reduce transaction costs and offer customers more competitive prices.[5] The intended goal of pricing disclosure is to incentivize dealers to reduce costs in order to remain competitive in the retail market. However, because the proposals only cover a subset of principal transactions, the proposals will predominantly impact small dealers that primarily transact on a riskless principal basis. Larger dealers that possess the capital to maintain significant inventories could be incentivized to hold positions to avoid disclosure.[6] As such, customers will not be able to effectively compare transaction costs across all market participants. They will not maintain an effective frame of reference to compare transaction costs between smaller introducing firms and larger dealers. Large broker-dealers that can avoid the disclosure period will not feel the downward pressure on their markups, but may paradoxically also receive an influx of new customers. Therefore, we believe that in an effort to ensure an even playing field for firms of all sizes, FINRA and the MSRB should consider a comprehensive pricing disclosure regime that does not limit bond market competition.

Additionally, we are concerned that a disclosure requirement that primarily impacts small dealers may cause these firms to choose to exit the market or only offer investors the opportunity

[5] FINRA Regulatory Notice, at 9; MSRB Regulatory Notice, at 13-14, 19, 21.
[6] FINRA Regulatory Notice, at 11; MSRB Regulatory Notice, at 16.

to invest in bonds through packaged products such as mutual funds. Sections 15A(b)(9) and 15B(b)(2)(C) of the Securities Exchange Act of 1934 require that FINRA and MSRB rules "not impose any burden on competition not necessary or appropriate in furtherance of the purposes of [the Act]."[7] While we appreciate the SROs including Economic Impact Assessments in accordance with their adopted frameworks, the proposals do not contain detailed discussions or any data regarding the impact on investor choice and access resulting from a reduction in the number of dealers servicing retail investors. Moreover, the proposals do not discuss any potential impacts on issuer borrowing costs or market liquidity that may result from a reduction in dealers. We ask that prior to further pursuing the proposals FINRA and the MSRB analyze the potential for such detrimental impacts and assess all associated costs. We believe that a more comprehensive proposal, rather than an incremental proposal, will help avoid these burdens on competition while increasing transparency for investors.

A comprehensive disclosure regime would also provide operational benefits for firms of all sizes. As we noted in our prior comment letters, confirmation disclosure of any sort, will be a costly and difficult undertaking for firms. These costs will be disproportionately high for small introducing firms which will have to work with clearing firms to alter and design manual systems. Compounding concerns regarding such costs is the possibility that the proposals represent the first step in a process to mandate additional pricing disclosure for all principal fixed income transactions. We are concerned that firms may be asked to build systems and adopt policies and procedures that may be obsolete or require significant overhaul in a matter of several years. In an effort to reduce the implementation burden we request that FINRA and the MSRB consult with the industry on its long-terms plans in an effort for all parties to work together to develop a single proposal that avoids the costs associated with continued incremental enhancements.

C. Regulatory Coordination

It is imperative that any pricing disclosure requirements adopted by FINRA and the MSRB be consistent in design. FINRA and the MSRB seek comment on a variety of proposals, none of which feature complete uniformity in requirements. Consistency is critical to ensure that dealers of all sizes maintain the ability to provide their customers access to a variety of products in a cost effective manner. Differing approaches to disclosure requirements necessitating separate systems and processes for corporate and agency securities as compared to municipal securities will unnecessarily raise compliance costs on broker-dealers. These increased costs may limit the ability of small firms to continue to offer one or more of the subject securities to clients.

Moreover, neither FINRA nor the MSRB has offered justification for differing approaches. The proposals primarily impact back office systems and processes. There is nothing inherently unique to either the market, or the back office systems, for one particular security that necessarily mandates a disclosure regime different from another type of fixed income security. A lack of consistency would only serve to increase costs to firms and confuse investors. A uniform approach is essential to ensuring efficient implementation and management while maximizing investor benefits.

In addition to coordinating with each other, we request that both FINRA and the MSRB work in coordination with the Department of Labor (Department) on its Proposed Class Exemption for

[7] Section 3(f) of the Securities Exchange Act of 1934 also requires the SEC to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation" when evaluating a proposed rule.

Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Principal Transaction PTE).[8] The Department, in conjunction with its proposal to amend the definition of investment advice fiduciary, has proposed to require markup disclosure for principal transactions in the following fixed income securities: U.S. Treasury securities, U.S. agency securities and dollar denominated U.S. corporate securities.[9] The requirement, as proposed, would apply to all principal transactions in those securities.

As we have noted, complying with a pricing disclosure proposal for fixed income transactions presents several operational challenges that will necessitate significant resources by broker-dealers. These challenges will be exponentially increased if firms are required to have different procedures apply to municipal debt securities, corporate and agency debt securities in non-retirement accounts and corporate and agency debt securities in retirement accounts. Such a result could further cause firms to reconsider their ability to offer certain products to investors. It is imperative that FINRA and the MSRB work with the Department to ensure that any markup disclosure requirement that is imposed on firms servicing retirement accounts is consistent with the requirements of a uniform pricing disclosure requirement issued jointly by FINRA and the MSRB.

II. Important Considerations For Pursuing Pricing Disclosure Requirements

A. Introduction

If FINRA and the MSRB further pursue any of the outstanding pricing disclosure proposals, or a more comprehensive proposal, we offer the following recommendations to help create an effective and efficient disclosure regime that is useful to investors. First, we believe that the pricing information to be disclosed should be based on the prevailing market price, which in most cases would be defined as the contemporaneous cost to the dealer. We recommend codifying a conclusive presumption of such definition for situations where there is an offsetting transaction after receiving a customer order. Second, we recommend that confirmations include the URL addresses of the homepages for TRACE and EMMA as well as the time of execution of the customer trade. Third, we suggest creating a good faith error safe harbor for instances where human error has inadvertently resulted in an inaccuracy on a customer confirmation. Lastly, we request that FINRA and the MSRB work with stakeholders to improve investor understanding of the fixed income markets and transaction pricing in an effort to put the disclosed pricing information in proper context.

B. Prevailing Market Price

We recommend that any potential pricing disclosure for transactions in fixed income securities should be based on the prevailing market price for the security at the time of the customer's trade. Utilizing the prevailing market price will ensure customers receive the most reasonably accurate understanding of the cost of their trade. Moreover, structuring pricing disclosure around prevailing market price will align any new disclosure requirements with existing fair pricing policies enforced by both FINRA and the MSRB.[10] We recognize that there may be transactions for which determining the prevailing market price may be complicated. We look forward to

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[8] 80 Fed. Reg. 21989 (April 20, 2015).
[9] *Id.* at 22003. The Department of Labor proposal would prohibit a broker-dealer from transacting in municipal securities with an IRA owner or employee benefit plan as a principal.
[10] FINRA Rule 2121; MSRB Rule G-30.

working with FINRA and MSRB on determining how to represent prevailing market price in situations where it may not be readily determinable.

Additionally, utilizing prevailing market prices would reduce the operational impacts of any pricing disclosure proposal. Small broker-dealers maintain manual processes to input the transaction information into a confirmation system and transmit that information to their clearing firm. The prospect of having to calculate reference prices based on an array of factors has caused some firms to believe they will need to hire additional personnel to handle confirmation inputs. Additionally, the prospect of human error increases in conjunction with an increase in the amount of information that must be inputted. Simplifying the required information to be disclosed should help reduce the costs and ease the implementation burden to be imposed on small dealers.

Lastly, we believe that in establishing the prevailing market price for the customer's security, there should be a rebuttable presumption codified in FINRA and MSRB rules for transactions where the firm refers to its contemporaneous costs. In most retail transactions, contemporaneous costs have long been considered a key factor in determining prevailing market price. We believe that codifying such a rebuttable presumption will provide necessary comfort to firms designing new systems and processes. Moreover, we believe the presumption of contemporaneous costs should be conclusive in situations where the dealer, after receiving an order for a security, executes a transaction to offset the customer's purchase or sale. In such a scenario the offsetting trade is usually very close in time to the customer trade such that considering additional factors for the determination of prevailing market price is unnecessary. We believe firms would appreciate the certainty in codifying a conclusive presumption for such trading scenarios.

C. Requiring Links to TRACE and EMMA

We appreciate FINRA and the MSRB's commitment to pursuing opportunities to increase promotion of the existing pricing transparency platforms, TRACE and EMMA. In our prior letters we recommended including a link to the appropriate website on the back of customer confirmations for fixed income securities trades. In their revised proposals, both FINRA and the MSRB note that these platforms are useful to inform investors of the market for their security at the time of their trade. The MSRB has proposed requiring the inclusion on the confirmations of all transactions for non-institutional customers of a hyperlink and URL address to the Security Details page for the customer's security on EMMA.[11] Additionally, the confirmation must also include a brief description of the type of information available on the page. The MSRB has further proposed to require the disclosure of the time of execution for a customer's trade to nearest minute.[12] Alternatively, FINRA has proposed including a link to TRACE on confirmations for corporate and agency securities.[13]

In assessing the impacts of requiring links to TRACE and EMMA on confirmations we wish to reiterate the importance of a consistent approach by FINRA and the MSRB. Consistent requirements are critical to limiting implementation burdens for firms. We suggest initially requiring a link to the TRACE or EMMA homepage and requiring the disclosure of the time of

[11] MSRB Regulatory Notice, at 12.
[12] *Id.* at 12-13.
[13] FINRA Regulatory Notice, at 5.

execution of the customer's trade.[14] We believe that including such a link in conjunction with the CUSIP number and time of execution will greatly assist investors in understanding the market for their security at the time of their trade. While including this additional information will necessitate changes to existing systems, we believe such changes are warranted and consistent with our belief that FINRA and the MSRB should seek to leverage existing transparency platforms in adopting pricing disclosure reforms.[15]

D. Safe Harbor for Good Faith Errors

In its proposal the MSRB specifically requests comment on a proposed amendment to its matched trading proposal that specifies that dealers would not be required to resend a confirmation solely due to a change in the reference transaction to be selected, the reference transaction price, or the differential between the customer price and the reference price.[16] We appreciate the MSRB's consideration of such a requirement and respectfully request that a similar provision be included in any proposal adopted by FINRA and the MSRB.

As we have discussed, including additional pricing information on customer confirmations will necessitate significant changes to systems and processes for both introducing and clearing firms. Clearing firms will need to adjust their interfaces to allow introducing firms to manually input the additional fields required on the confirmations. Clearing firms must then capture such information, store it, and provide correspondents an opportunity to review and correct the information to be included on the confirmation. Such manual processes necessitate an investment of time by introducing firm personnel and carry a significant degree of operational risk. These processes carry a significant likelihood of human error that will result in increased costs to firms to correct inaccurate information.

Moreover, these difficulties are further compounded by the shortened settlement cycle initiative that is currently underway.[17] Small firms will typically input and transmit all information to be included on confirmations to their clearing firms at the end of the trade day. Moreover, the matched trading proposals would effectively require such end of day reporting. Requiring additional information to be manually inputted while also shortening the time for completion and transmission of such information only increases the costs and risk to introducing firms.

Therefore, we request that FINRA and the MSRB consider including a good faith safe harbor to ease the burden on small fully-disclosed introducing firms. Such a safe harbor would ensure that dealers would not be required to resend a confirmation, should printed information be mistakenly inaccurate so long as the dealer undertook a good faith effort to include accurate information on the confirmation and the correct identity and pricing information is available to the customer on an account statement or through online account access. Firms wishing to avail

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[14] Limiting the requirement to the TRACE or EMMA homepage would still provide the opportunity to assess whether the inclusion of such a link materially impacts investor traffic to such web-platforms. FINRA and the MSRB could always choose to revise such a requirement to include a security-specific link if it was necessary.

[15] These operational and technological impacts would be significantly greater if a security specific link were to be required. In addition to developing the technology to ensure inclusion of the appropriate link on a transaction-by-transaction basis, dealers would need to adopt policies and procedures to manually check each URL prior to submission to ensure that it is the correct link for the customer's security. We do not believe that the benefits of including a security-specific link outweigh these significant costs.

[16] MSRB Regulatory Notice, at 24.

[17] See Letter from Mary Jo White, Chair, SEC, to Kenneth E. Bentsen, Jr., President & CEO, SIFMA & Paul Schott Stevens, President & CEO, ICI (Sept. 16, 2015); *see also* MSRB Regulatory Notice 2015-22.

themselves of such a safe harbor would need to state on the confirmation that in the event printed information contains technical inaccuracies or errors, the corrected information will be available to the client on either an account statement or through online account access. Providing such a safe harbor would significantly reduce the operational impacts on small firms – as well as medium and large firms – and may positively contribute to small firms' decisions to continue to offer fixed income securities to retail investors.

E. Investor Education of Fixed Income Trading and Pricing

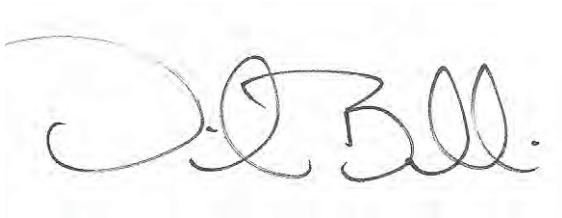
Should FINRA and the MSRB choose to pursue pricing disclosure requirements for retail fixed income transactions where the dealer acts as principal, we believe they should also undertake initiatives to seek to better educate investors about the structure of the secondary fixed income markets. Such education is necessary to put pricing information in context. 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. Educating investors on the roles that broker-dealers play in executing fixed income securities transactions and the steps that must be undertaken to fairly and reasonably fill a customer order are as essential as pricing information. We respectfully request FINRA and the MSRB undertake initiatives to provide such education and we stand ready to assist such efforts in any way we can.

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with FINRA and the MSRB on these and other important regulatory efforts. We believe that a more comprehensive approach will better balance the importance of increasing transparency for investors with ensuring investor choice and access to firms of all sizes.

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

Respectfully submitted,



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December 10, 2015

Via Electronic Submission

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Re: *FINRA Regulatory Notice 15-36, Pricing Disclosure in the Fixed Income Markets*
MSRB Regulatory Notice 2015-16, Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers

Dear Ms. Asquith and Mr. Smith:

LPL Financial LLC ("**LPL**") welcomes the opportunity to comment on the Financial Industry Regulatory Authority's ("**FINRA**") Regulatory Notice 15-36 ("**FINRA Proposal**") and the Municipal Securities Rulemaking Board's ("**MSRB**") Regulatory Notice 2015-16 ("**MSRB Proposal**", collectively the "**Proposed Rules**").[1] We commend FINRA and the MSRB for the consideration given to the comments provided on the previous proposals and the revisions made to address these comments.

LPL supports the efforts of FINRA and the MSRB to improve transparency for investors regarding fixed income transactions by requiring disclosure of mark-ups and mark-downs on confirmations. We recommend a consistent approach that uses prevailing market price to calculate the mark-up or mark-down. To the extent that regulators anticipate further rulemakings to apply similar disclosure requirements to categories of fixed income securities not addressed by the Proposals, LPL respectfully requests that the MSRB and FINRA consider adopting a standard that could also be applied to those other categories. Given the operational challenges involved in adding the disclosures to confirmations, we recommend that regulators afford 18 to 24 months to implement the ultimate changes resulting from the Proposals. We hope that

[1] *See* FINRA Regulatory Notice 15-36, Pricing Disclosure in the Fixed Income Markets (Oct. 12, 2015), available at: https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-15-36.pdf (last visited Dec. 9, 2015) [referred to herein as the "FINRA Proposal"]; MSRB Regulatory Notice 2015-16, Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers (Sept. 24, 2015), available at: http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2015-16.ashx (last visited Dec. 9, 2015) [referred to herein as the "MSRB Proposal"].

FINRA and the MSRB find our comments helpful and we look forward to continued collaborations with FINRA and the MSRB on these important Proposals.

I. OVERVIEW OF LPL

LPL is a leader in the retail financial advice market and, as of September 30, 2015, serves about $462 billion in advisory and brokerage assets. LPL is one of the fastest growing RIA custodians and is the nation's largest independent broker-dealer.[2] We provide proprietary technology solutions, comprehensive clearing and compliance services, practice management programs and training, and independent research to more than 14,000 independent financial advisors and over 700 banks and credit unions. Our financial advisors provide financial advice to investors with assets in approximately 4.6 million client accounts. They service an estimated 40,000 retirement plans with an estimated $115 billion in retirement plan assets, as of September 30, 2015. LPL also supports approximately 4,300 financial advisors licensed and affiliated with insurance companies with customized clearing, advisory platforms and technology solutions. LPL and its affiliates have about 3,400 employees with primary offices in Boston, Charlotte, and San Diego.

LPL helps independent financial advisors establish their own successful businesses through which they can offer independent financial guidance and advice to investors. Our independent financial advisors build long-term relationships with their clients and communities across the U.S. by guiding them through the complexities of investment decisions, retirement solutions, financial planning, and wealth management. In addition, LPL supports financial advisors and program managers at community and regional banks and credit unions by enabling them to offer investors a wide array of investment, advisory, and insurance products.

LPL executes fixed income trades for investors on an agency or riskless principal basis. LPL does not take positions in fixed income securities nor does it trade fixed income securities on a proprietary basis.

II. OVERVIEW OF THE PROPOSALS

Both Proposals are designed to provide greater transparency in the area of fixed income mark-ups and mark-downs. The Proposals seek to accomplish this by requiring firms to disclose additional information about the remuneration earned by the firm in fixed income transactions that are executed for retail customers on a principal basis (including riskless principal). The disclosure requirements in the both Proposals are triggered when a firm executes a buy (sell) transaction as principal in the same security as a retail customer's sell (buy) transaction but differ

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[2] *See* C. Paikert, FP50: New Ways to Get Huge, FINANCIAL PLANNING (June 1, 2015), available at: http://www.financial-planning.com/news/industry/fp50-new-ways-to-get-huge-2693025-1.html (last visited Dec. 9, 2015).

with respect to the required timing of those transactions. The FINRA Proposal requires disclosure if the principal transaction is executed within the same day as the customer transaction. The MSRB Proposal, on the other hand, requires disclosure only if the principal transaction(s) is executed by the firm within two hours of the customer transaction.

The Proposals also require firms to disclose different information with respect to mark-ups or mark-downs earned by the firm on the principal transaction. The FINRA Proposal requires disclosure of the price paid by the customer, the price paid by the firm for the principal transaction[3], the differential between the price to the customer and the firm's price, and a hyperlink to additional information on the Trade Reporting and Compliance Engine ("**TRACE**"). In contrast, the MSRB Proposal requires disclosure of the firm's mark-up or mark-down from the prevailing market price expressed as both a total dollar amount and percentage. The prevailing market price for these purposes is derived from the firm's purchases (sales) that meet or exceed the size of the customer's sale (purchase) within two hours of the customer transaction. In addition, firms are required to include a hyperlink to the Electronic Municipal Market Access ("**EMMA**").

III. RECOMMENDATIONS

A. Disclosing Mark-ups and Mark-downs Using Prevailing Market Price

The MSRB Proposal provides statements of the SEC Commissioners calling for disclosure of mark-ups and mark-downs to help investors understand their transaction costs.[4] LPL supports this initiative and recognizes the benefits to investors resulting from increased transparency regarding fixed income securities transactions. In addition to satisfying the SEC's objective, the MSRB Proposal's basis for calculating the mark-ups and mark-downs is consistent with existing regulatory guidance regarding the prevailing market price.[5] LPL supports using the prevailing market price methodology for calculating the mark-up or mark-down and recommends that the proposed approach apply to all categories of retail principal transactions in the categories of securities listed in the Proposed Rule.[6]

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[3] The price paid by the firm is referred to by FINRA as the "Reference Price".

[4] *See* MSRB Proposal, notes 15-17.

[5] *See, e.g.*, MSRB Rule G-30.01(d) Supplementary Material (stating in relevant part, "[d]ealer compensation on a principal transaction is considered to be a mark-up or mark-down that is computed from the inter-dealer market price prevailing at the time of the customer transaction"). We do not take a position as to the appropriateness of the different proposed time constraints for identifying prevailing market price.

[6] For firms such as LPL that transact primarily as riskless principal, the prevailing market price presumptively will be the firm's contemporaneous cost.

B. The Proposals Should Be Consistent and Should Strive for Consistency with Potential Additional Proposals Covering Fixed Income Products

By requiring firms to adhere to a single standard – *i.e.*, disclosure of the mark-up or mark-down based on the prevailing market price – firms will only have to implement a single solution to comply with both Proposals.[7] A single standard is operationally more efficient and can still provide investors with transparency about mark-ups and mark-downs. Further, the calculation of mark-ups or mark-downs based on prevailing market price is relevant to retail transactions in all categories of fixed income securities including corporate, agency, and municipal, and any other categories that may in the future become subject to disclosure requirements similar to those discussed in the Proposals. We ask that the proposed disclosure requirements be structured such that they could be consistent with any future requirements for disclosure of mark-ups and mark-downs for other categories of fixed income products.

LPL also notes that the Department of Labor ("**DOL**") has proposed, as part of its fiduciary rule principal transaction exemption proposal, a requirement that firms provide the mark-up or mark-down on a principal transaction to investors before obtaining consent to a transaction, and then again on the confirmation.[8] To avoid requirements that could overlap or be inconsistent with each other, we respectfully request that the regulators coordinate their requirements for confirmation disclosures.

A single standard for confirmation disclosures of mark-ups and mark-downs would be less confusing to investors. One of the primary purposes of the transaction confirmation is to provide "a means by which to evaluate the costs of . . . [a] transaction and the quality of . . . [the] broker-dealer's execution."[9] If the means by which a customer evaluates the cost of a transaction changes with each category of fixed income product, and the customer does not understand the differences between each disclosure requirement, the overall value of the disclosure will diminish. Applying a single standard to all fixed income security transactions will lessen the likelihood of customer confusion while continuing to provide important transparency.

C. Sufficient Time to Implement

Implementing the new confirmation disclosure requirements will be operationally challenging. In order to prepare information for a confirmation that includes the relevant mark-

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[7] *See* FINRA Proposal at 6 (stating, in relevant part: "[w]hile FINRA and the MSRB's revised proposals currently differ, both entities favor a coordinated approach.").

[8] *See* Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, 80 FR 21989 (April 20, 2015).

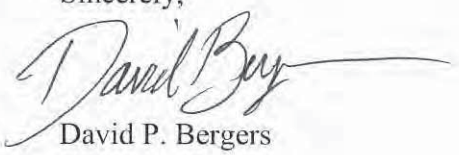
[9] *See* SEC Investor Bulletin, *How to Read Confirmation Statements* (Sept. 2012), available at: https://www.sec.gov/investor/alerts/ib_confirmations.pdf (last visited Dec. 9, 2015).

up or mark-down, firms will likely need to implement time-consuming system changes. Among other things, firms will need to develop real-time systems to identify related transactions and that are capable of identifying and accounting for any cancellations and corrections. Significant coordination will be required with third party vendors that assist with the creation, processing, and distribution of the confirmations. LPL believes the system changes and the testing of those system changes will require significant time to complete, and asks FINRA and the MSRB to consider providing 18 to 24 months for implementation.

* * * * *

We appreciate your consideration of these comments. We respectfully submit that the recommendations discussed in this letter will help to clarify the new rule requirements while fulfilling the key purposes underlying the Proposals. We would be pleased to provide additional information regarding any of these issues. If you have any questions regarding this letter or would like to discuss any of these points further, please do not hesitate to contact me or Sarah Gill, Senior Vice President and Head of Policy, Government Relations, at (202) 510-1025.

Sincerely,



David P. Bergers

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December 8, 2015

Submitted via email to pubcom@finra.org
Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Submitted electronically
Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: FINRA Regulatory Notice 15-36: Request for Comment on Pricing Disclosure in the Fixed Income Markets
MSRB Regulatory Notice 2015-16: Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers

Dear Ms. Asquith & Mr. Smith:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by the Financial Industry Regulatory Authority ("FINRA") and the Municipal Securities Rulemaking Board (MSRB) relating to both investor protection and disclosures to public investors.

FINRA has reissued its request for comment on a proposed FINRA rule that would require firms to disclose additional information on customer confirmations for transactions in fixed income securities. Specifically, for corporate and agency debt securities, FINRA is proposing that firms disclose the price to the customer, the member's reference price, and the differential between those two prices, along with a reference and hyperlink, if available, to the TRACE publicly available trading data. However, this information must be disclosed only if certain conditions are met. The MSRB has also requested comment on a similar proposal to require confirmation disclosure of mark-ups for specified principal transactions in municipal debt securities.

PIABA generally applauds any effort to provide more transparency in the securities trading arena, and specifically with respect to debt securities. FINRA has restructured the proposed rule to eliminate the "qualifying size" aspect of the previous proposal, replacing it with a "retail customer" standard. PIABA supports this change and agrees that the rule should apply to all retail customer account regardless of the size of the transaction.

The proposed rule limits disclosure of this information to only those transactions where the firm has executed a transaction as a principal in the same security within the same day that equals or exceeds the size of the customer transaction. PIABA believes that this is too limited. PIABA would like to see fixed income trade confirmations disclose the actual markups/markdowns, not only for riskless transactions, but for all fixed income retail transactions.

As the rule stands now, the markup/markdown disclosure would be required only if there are corresponding firm trades on the same day. Regulatory Notice 14-52 provided several examples of possible scenarios which set forth when disclosure would and would not have to be made. For example, in RN 14-52 example 13, disclosure would not be required where Firm A sold 100 XYZ bonds to its customer on Day 2, if 50 of the bonds having been sourced at 15:30:00 PM on Day 1 and 50 of them having been sourced at 10:00:00 AM on Day 2. PIABA would prefer that all of the pricing information be disclosed, regardless of whether the bonds sold to the customer were sourced on Day 1 or Day 2. At a bare minimum, pricing information should be provided for the 50 bonds that were sourced on Day 2 – the day on which the bonds were sold to the client. Absent such a requirement, there is a meaningful incentive for member firms to game the system by sourcing a single bond for each customer sale from old inventory, thereby avoiding entirely the need to disclose the markup/markdown.

With respect to the approach proposed by the MSRB, PIABA feels the MSRB unnecessarily limits the time period it looks at when determining when information needs to be disclosed. The MSRB would only require disclosure if the principal transaction occurs within two hours preceding or following the customer transaction. This is unnecessarily limited. As stated above, PIABA believes this information should be disclosed in all cases, but at a minimum, for transactions occurring in the same day.

The new proposal also permits a firm to not disclose pricing information if there has been a material change in the price of the security between the time of the principal transaction and the customer transaction. PIABA is concerned that the proposal allows the firm to exercise too much discretion in whether to disclose the price along with clarifying information explaining the change in price, or simply not disclose the price at all. FINRA should provide guidance on what it considers a material change. For example, FINRA should provide a minimum percentage change in price or other objective measure.

Further, PIABA does not understand the need for this discretion. The firm should be required to disclose the price and the reason for the material change in price. This information should be readily ascertainable and should be disclosed to the customer. Alternatively, the firm should be required to disclose that there had been a material change in price and that the customer should contact their broker for more information.

PIABA also believes that FINRA should work to unify its rule with the MSRB proposal. Customers should receive uniform information about debt securities, including corporate and agency bonds and municipal bonds. Firms should provide both the reference price and the mark-up or mark-down from the prevailing market price to the extent the two are different. PIABA is supportive of the MSRB proposal in that it looks through the firm to its affiliates for purposes of determining when a transaction is a "principal" transaction.

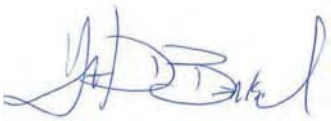
Abuse of undisclosed markups and markdowns is not a hypothetical problem. The last few years have seen FINRA pursue a number of disciplinary actions against member firms concerning excessive markups and markdowns of debt instruments. For example, in 2012, FINRA fined Citi International Financial Services LLC $600,000 and ordered more than $648,000 in restitution and interest to more than 3,600 customers for charging excessive markups and markdowns on corporate and agency bond transactions.[1] In 2013, FINRA fined StateTrust Investments, Inc. over $1 million for charging excessive markups and markdowns in corporate bond transactions and ordered the firm to pay more than $353,000 in restitution and interest to customers who received unfair prices. FINRA found that 85 of the transactions, in particular, operated as a fraud or deceit upon the customers.[2] Also in 2013, FINRA fined Morgan Stanley Smith Barney LLC and Morgan Stanley & Co. LLC $1 million and ordered $188,000 in restitution plus interest for failing to provide best execution in certain customer transactions involving corporate and agency bonds, and failing to provide a fair and reasonable price in certain customer transactions involving municipal bonds.[3] Had the pricing information been available to the customers on the confirmations, perhaps the customers would have been charged fair prices.

To be clear: PIABA supports the amendments to FINRA Rule 2232 and MSRB Rule G-15 insomuch as they create greater transparency in retail fixed income trading. However, PIABA requests the amendments not be limited in scope or time and apply to affiliate transactions and to transactions that occur outside the limited windows proposed by both FINRA and the MSRB. There is nothing to indicate that unfair pricing or excessive markups and markdowns only occur when the transaction is sourced from a same-day principal trade.

Ultimately, PIABA requests that the MSRB and FINRA move forward on these proposals. Both entities issued initial proposals a year ago. The MSRB notes that the SEC has expressed concerns about transparency in the municipal securities market since 2012. The disciplinary actions cited above demonstrate that there have been issued in the corporate and agency debt markets for some time as well. However, neither entity has yet proposed a rule to the SEC. At the current pace, it will be some time before rules are enacted. PIABA urges each entity to expedite this process and act expeditiously to protect customers who are participating in the debt securities markets.

Thank you for the opportunity to comment on the rule proposal.

Sincerely yours,



Hugh D. Berkson
PIABA President

[1] *See* http://www.finra.org/newsroom/newsreleases/2012/p125821.
[2] *See* http://www.finra.org/Newsroom/NewsReleases/2013/P288973.
[3] *See* http://www.finra.org/Newsroom/NewsReleases/2013/P317817.

charles SCHWAB

December 11, 2015

BY ELECTRONIC MAIL

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority 1735 K Street, NW
Washington, DC 20006-1506

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: FINRA Regulatory Notice 15-36,
Pricing Disclosure in the Fixed Income Markets

MSRB Regulatory Notice 2015-16,
Request for Comment on Draft Rule Amendments to
Require Confirmation Disclosure of Mark-ups for Specified Principal
Transactions with Retail Customers

Dear Ms. Asquith and Mr. Smith:

Charles Schwab & Co. Inc. ("Schwab") appreciates the opportunity to comment on the recent rule proposals by the Financial Industry Regulatory Authority ("FINRA") and the Municipal Securities Rulemaking Board (the "MSRB") regarding the disclosure of certain pricing and mark-up or mark-down (collectively "mark-up") information on customer confirmations for qualifying retail transactions in fixed income securities (the "2015 FINRA Proposal", the "2015 MSRB Proposal", and collectively the "2015 Proposals").

Schwab understands that the 2015 Proposals are an attempt to address the comments and concerns raised in response to FINRA Regulatory Notice 14-52 and MSRB Notice 2014-20 (the "2014 FINRA Proposal", the "2014 MSRB Proposal", and collectively the "2014 Proposals").

Schwab has been a long-time proponent of disclosing transaction-related costs across all asset classes and currently provides information on confirmations for customers on its retail platform related to the mark-ups it charges on municipal, corporate, and government agency bond transactions. Schwab believes that it is important for

investors to understand how bond pricing works and how the associated costs will ultimately determine the price of the bond they purchase or sell. Schwab has made resources available to its clients that describe how bonds are priced and how those prices can ultimately impact the yield received on a bond transaction. In addition, Schwab makes available to its clients pricing information from both FINRA and the MSRB. Schwab firmly believes that the more investors understand about pricing and the markets, the better they will be able to judge the fairness and value of the services they receive. To that end and as further described below, Schwab believes that an expanded approach to disclosing transaction related costs coupled with consistent and reasonable rulemaking in this area would be helpful to market participants and retail investors alike.

Schwab appreciates FINRA's and the MSRB's willingness to listen to and incorporate some of the feedback provided in response to the 2014 Proposals into the 2015 Proposals. While both sets of Proposals have been an important step toward improving price transparency and better informing retail investors' understanding of the fixed income securities markets, as more fully described below, Schwab believes that an expanded approach to mark-up/pricing disclosure whereby all principal transactions are included can have a greater impact for retail investors and the market as a whole.

Concerns with the 2014 and 2015 Proposals

Schwab, like many other market participants, believes that using a "reference price"[1] as proposed by FINRA would not have the intended effect of increasing transparency into transaction costs and dealer compensation related to fixed income transactions. Rather, we believe that such an approach would be difficult for dealers to implement, potentially difficult for retail investors to understand, and most importantly, may not provide meaningful information related to the costs associated with a particular transaction. As the MSRB succinctly explained in its 2015 Proposal, the reference price approach would, "utilize potentially complicated methodologies to determine which of the potentially many transactions should be used as a comparator for purposes of disclosing to the customer pricing reference information".[2] Schwab believes that such a complicated approach would not necessarily improve transparency nor would it improve retail investors' understanding of the fixed income securities markets. In fact, it has the potential to exacerbate investor confusion.

For example, under the proposed "reference price" methodology, a customer might receive a reference price disclosure for the execution of one lot of a particular order, but no disclosure for another lot of the same order. Another possible scenario is that a particular reference price disclosure would infer that a dealer lost money on a transaction with a customer, even though a mark-up was charged. If a goal of the Proposals is to provide greater transparency into transaction costs and dealer

[1] See FINRA Regulatory Notice 15-36, Pricing Disclosure in the Fixed Income Markets (October 2015).
[2] See MSRB Notice 2015-16, Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers (September 2015).

compensation associated with trading fixed income securities, Schwab believes that a reference price approach would result in many scenarios that would not meet that objective.

While Schwab is in agreement with both FINRA and the MSRB that pricing and mark-up disclosure has the potential to positively impact the market, we believe that the 2015 Proposals are either too complex (as described above), or may not go far enough in providing meaningful pricing/mark-up information to retail investors (as more fully described below).

First and foremost, Schwab believes it is imperative that FINRA and the MSRB coordinate with each other to ensure that their proposals are consistent, except for any differences mandated by the unique market structures of the covered securities. As presently written, the two proposals are markedly different and would be expensive and difficult to implement and maintain in parallel, and ultimately would confuse retail investors and stray from the stated objectives of the Proposals. In addition, FINRA and the MSRB must also consider pending rulemaking by the Department of Labor,[3] which in its present form would impose yet another disclosure regime for certain principal fixed income transactions in retirement accounts.

At a high level, under the 2015 FINRA Proposal, with some exceptions, for specified security transactions occurring on the same trading day, firms/members would be required to disclose on retail customer confirmations: the price to the customer; the firm's "reference price"; and the difference between the two prices. Generally speaking, the "reference price" would be based upon the price at which the firm/member acquired or sold the subject security on the same trading day.

Under the 2015 MSRB Proposal, firms/members would be required to disclose on retail customer confirmations its mark-up or mark-down (collectively "mark-up") from the "prevailing market price" for the security, expressed as a total dollar amount and as a percentage of the principal amount of the transaction for principal transactions for which the firm had transacted on the same side of the market within the two hours preceding or following the customer transaction.

Of the two 2015 Proposals, Schwab believes the 2015 MSRB Proposal has the greatest potential to be effective at achieving the stated goals of FINRA, the MSRB, and the Securities and Exchange Commission[4] in the area of fixed income price transparency. As noted above, under the 2015 MSRB Proposal, the mark-up required to be disclosed would be the difference between the price to the customer and the prevailing market

[3] Department of Labor, Employee Benefits Security Administration. Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, Application No. D-11713 [ZRIN: 1210-ZA25], 80 Federal Register 21989 (April. 20, 2015).
[4] U.S. Securities and Exchange Commission, Report on the Municipal Securities Market,(July 31, 2012).

price ("PMP") for the security. The presumption as noted in the 2015 MSRB Proposal is that the PMP for the security would be established by referring to the dealer's contemporaneous cost as incurred, or the contemporaneous proceeds as obtained, which is consistent with applicable MSRB and FINRA rules.[5]

Schwab is concerned that any "reference price" methodology may too often fail to provide customers with clear and accurate disclosure of dealer mark-ups. Disclosure of differences between customer prices and reference prices for dealer risk trades will reflect market price fluctuations and, as previously mentioned, may infer a dealer loss on a transaction with a customer for which the dealer charged a mark-up.

Additionally, proposed reference price differential disclosures would require dealers to delay the confirmation process until the end of the day, potentially presenting significant operational and technological challenges. More importantly, delaying the calculation of the required disclosure until the end of the day would preclude dealers who wish to do so from providing the disclosure to customers at the point of sale. Customers of those dealers who disclose mark-ups at point of sale will inevitably be confused by reference price differential disclosures on trade confirmations that differ from the dealers' point of sale mark-up disclosures. This is one reason Schwab believes it is imperative that the disclosure requirement be based on a price that already exists at the time of trade, such as the PMP, rather than on prices that occur in the future.

Schwab Supports Expanding the MSRB's Proposal to Include All Principal Trades

While we agree with the general principles of the MSRB's Proposal, Schwab recommends going further. We believe that disclosing the mark-up from the PMP for all principal trades in municipal, corporate, and government agency bonds regardless of the time frame or whether the dealer had transacted on the same side of the market would provide even greater transparency into the compensation and costs associated with the execution of transactions and would provide significantly more benefits to investors and to the marketplace as a whole. In addition to providing increased benefits to retail investors, Schwab believes that such an approach would also more closely align the fixed income markets with the disclosure requirements currently in place in the equity markets.

As noted in the 2015 MSRB Proposal, in principal transactions, "...the total transaction price to the customer must bear a reasonable relationship to the prevailing market price of the security at the time of the customer transaction, and the mark-up, as part of the aggregate price, must also be fair and reasonable. For purposes of [MSRB] Rule G-30, the mark-up is calculated based on the inter-dealer market price prevailing at the time of the customer transaction." As the MSRB notes in their Proposal, dealers are already subject to regulatory obligations related to the fairness and reasonableness of mark-ups, and the determination of PMP in connection with the establishment of a fair price, as such, it is a reasonable assumption that dealers should be able to provide the

[5] See MSRB Rule G-30 and FINRA 2120.

amount of the mark-up over the PMP for all principal transactions, not just those for which they've transacted on the same side of the market within two hours of the customer's transaction or during the same trading day.

Under this expanded disclosure approach, dealers and customers would not have to interpret newly defined terms such as "reference price", "complex trades", or the timing of "specified principal transactions." Nor would dealers need to determine if there is a specified trade size associated with the customer's transaction. As the MSRB notes in its 2015 Proposal when discussing an alternative regulatory approach which would include all principal transactions, "[S]uch a requirement may eliminate the need for dealers to develop any type of matching utility to determine which customers receive disclosure and would allow confirmations to be printed immediately following the customer's transaction." Dealers would simply need to disclose the mark-up from the PMP which they presumptively have already calculated. This approach would be consistent with current requirements to disclose agency commissions on fixed income transactions. As long as dealers are held to the same standards for calculating PMP, Schwab believes that this approach would provide investors with even greater transparency into the compensation of their dealers and the costs associated with the execution of their transaction. Schwab believes that this approach would also simplify dealer obligations under the 2015 Proposals and mitigate behavior, intentional or not, that could lead to the appearance of circumventing the intended benefits of the 2015 Proposals.

While Schwab believes that this approach is more straightforward and would achieve both FINRA's and the MSRB's stated objectives, it would likely require updated guidance from both FINRA and the MSRB on the determination of PMP and on what constitutes a mark-up. Collectively, this guidance could equate to a "reset" for dealer expectations and go a long way toward ensuring a level playing field going forward.

Additional Comments

Disclosure Format

Schwab is supportive of the MSRB's proposal to express the mark-up both as a total dollar amount and as a percentage of the principal of the customer transaction. Schwab requests that sufficient time be allowed for required system updates to be made in order to implement these changes.

Retail Customers in the Secondary Market

Schwab supports using a definitional approach in identifying which trades would be subject to the disclosure requirements of the 2015 Proposals. Schwab feels that a "retail account" or "non-institutional account" as defined by FINRA and MSRB rules is a more appropriate method to capture covered transactions as opposed to the $100,000 par amount threshold put forth in the 2014 Proposals. In addition, Schwab supports limiting disclosure obligations to transactions which occur in the secondary market.

"Look Through" for Specified Trading Structures

Schwab strongly believes that any final rule must include a "look through" provision for specified trading structures. Schwab agrees with the MSRB assertion that such a provision would ensure that the mark-up disclosed is a more accurate indication of the compensation paid by customers when affiliated dealers effectively function as a single entity for the purposes of executing customer transactions. If such transactions were not captured by the rule, Schwab believes that customers of firms who have separate trading desks within affiliated entities would not be afforded the benefits intended by the 2015 Proposals. Such disclosure would, in our opinion, help ensure a level playing field for all market participants.

Functionally Separate Trading Desks

While Schwab understands and generally agrees with the reasoning behind excluding transactions effected on functionally separate trading desks from the disclosure requirements of the 2015 Proposals, we believe that such exclusions must be coupled with information walls and rigorous oversight. Lack of such controls could limit the manifestation of the 2015 Proposals' stated objectives.

Security-Specific Link to EMMA and TRACE, and Time of Execution

Schwab is supportive of the proposal to add a security-specific link to EMMA and FINRA's TRACE websites. Schwab believes that the additional information available on EMMA and TRACE can be a valuable resource for investors and market participants. As both FINRA and the MSRB can appreciate, the provision of security-specific links will require a great deal of coordination with industry participants to ensure that links remain functional and accurate. FINRA and the MSRB would have to commit to a process by which they notify industry participants of planned updates and outages of their systems to ensure ongoing connectivity. In addition, due to already limited physical space on customer confirmations, such URLs would need to be appropriately sized to ensure that firms can fit them into the limited space available on confirmations. Should the MSRB and FINRA adopt Schwab's proposal to disclose mark-ups from the PMP, we believe that time of execution would not be a necessary data point for confirmations.

In general, Schwab believes that evaluating the costs and burdens of any new rule requirements and weighing those costs against any benefits derived from them is critical to ensure efficient and effective rulemaking. Before any new requirements are created, FINRA and the MSRB should conduct a thorough cost-benefit analysis of requirements set forth in these Proposals.

Thank you for your consideration of the points we have raised in this letter and we hope that you find that our comments are useful in helping to formulate your final rules. Please feel free to contact Michael Moran at (415) 667-0902 if you have any questions.

Sincerely,

Jason Clague
Senior Vice President
Trading & Middle Office Services
Charles Schwab & Co., Inc.

sifma
Invested in America

December 11, 2015

BY ELECTRONIC MAIL

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Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314-3412

Re: FINRA Regulatory Notice 15-36
Pricing Disclosure in the Fixed Income Markets

MSRB Regulatory Notice 2015-16,
Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers

Dear Ms. Asquith and Mr. Smith:

The Securities Industry and Financial Markets Association[1] ("SIFMA") appreciates the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA's") Regulatory Notice 15-36 and the Municipal Securities Rulemaking Board's ("MSRB's") Regulatory Notice 2015-16 (together the "Revised Proposals" or the "Proposals"). SIFMA submits this letter as a supplement to its submission of January 20, 2015 regarding FINRA's Regulatory Notice 14-52 and the MSRB's Regulatory Notice 2014-20 (the "Initial Proposals"). We incorporate by reference our prior comment in this proceeding.

SIFMA strongly supports efforts to enhance bond market price transparency in a way that provides retail investors with useful, clear, and consistent insight into their

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

transactions, and appreciates the deep engagement with our members by both FINRA and the MSRB over the past several months concerning this issue.

As a preliminary matter, any new confirmation disclosure requirement must be uniform in design and operation. As we emphasized throughout our prior comments, there is no policy justification for adopting divergent approaches or terminology in this context. Unfortunately, the Proposals provide two fundamentally different formulations for what any confirmation disclosure should entail. FINRA and the MSRB have not identified any benefit to requiring firms to implement, at enormous cost, two different rules. We again urge FINRA and the MSRB to adopt a uniform rule with identical requirements and language.

Consistent with our earlier comments, SIFMA continues to maintain that the Proposals impose unjustified costs and burdens and that investors would be better served by alternatives that focus exclusively on increasing usage of the abundance of market data and investor tools already available on TRACE and EMMA. Nevertheless, while we believe our arguments in this regard are correct, we focus this letter on FINRA's and the MSRB's determination to implement rules requiring confirmation disclosure related to bond pricing.

Although we continue to believe that any retail confirmation disclosure with specific pricing information should apply solely to trades in which no market risk attaches to the dealer effecting the transaction (*i.e.*, "riskless principal transactions"), we understand that FINRA and the MSRB have favored a more expansive approach. Accordingly, we believe strongly that, should some form of the Proposals proceed, FINRA and the MSRB should embrace a two-hour time frame for disclosure of firm and retail customer trades. A two-hour window, as proposed by the MSRB, would capture nearly all of the relevant universe of firm and customer trades and is a more reasonable proxy for contemporaneous trade disclosure than the same-day window proposed by FINRA. As the time period between firm and customer trades increases, any disclosure requirement becomes considerably more complex for dealers to implement and, given the difficulty of matching trades in complex scenarios separated by time, price fluctuations and market volatility, more difficult for customers to understand.

Should some version of the Proposals proceed, SIFMA urges FINRA and the MSRB to adopt a uniform rule that provides firms with the flexibility to adopt a matching framework, a prevailing market price framework, or an alternative readily determinable price reference framework, subject to further regulatory guidance. For example, one potential alternative approach is a daily volume weighted average (market) price ("VWAP"). While some firms already have adopted a prevailing market price framework, such approach may be difficult for firms with different business models to implement. Given the diversity of business models and technology configurations among firms, FINRA and the MSRB should allow for a level of flexibility among these frameworks and not impose a rigid model on the entire securities industry that imposes disparate burdens and unnecessary costs. With or

without that flexibility, additional guidance may be necessary for implementation across the marketplace. In addition, while FINRA and the MSRB have addressed some of our concerns with the Initial Proposals, serious structural and operational issues with the Revised Proposals must be addressed.

Accordingly, if some form of the Proposals does proceed, FINRA and the MSRB must provide clear and uniform guidance that leads to relevant customer disclosure, is administratively and operationally feasible, and maintains the liquidity of the debt marketplace. We would welcome the opportunity to engage further with FINRA and the MSRB to help define specific guidance in that regard.

DISCUSSION

I. ANY NEW FINRA AND MSRB CONFIRMATION DISCLOSURE REQUIREMENTS MUST BE UNIFORM IN DESIGN AND OPERATION.

As a preliminary matter, any new FINRA and MSRB confirmation disclosure requirements must be uniform in design and operation. As SIFMA stressed in its initial comment letter, there is no policy justification for having divergent approaches or terminology in this context. Recognizing that there is no reason for two completely different disclosure regimes in this area, FINRA and the MSRB again have promised that "both entities favor a coordinated approach" to potential rulemaking.[2] We urge FINRA and the MSRB to embrace uniformity and not simple coordination by adopting a harmonized rule that provides firms with the flexibility to adopt various methodologies for compliance as described in Part IV.

Unfortunately, this "coordinated approach" has thus far failed to produce a uniform proposed rule and has instead provided two fundamentally different formulations for what any confirmation disclosure should entail. As described in Part III, FINRA's Proposal requires disclosure of firm and retail customer trades within an expansive same-day window, while the MSRB's Proposal targets a two-hour window. As described in Part IV, FINRA's Proposal suggests a reference price matching framework, while the MSRB's Proposal suggests a prevailing market price standard. The Proposals fail to articulate any benefit to requiring each firm to implement, at

[2] FINRA Regulatory Notice 15-36 at 6 ("While FINRA and the MSRB's revised proposals currently differ, both entities favor a coordinated approach. Accordingly, FINRA is inviting comments on the MSRB's proposal in comparison to FINRA's revised proposal, and whether the MSRB's proposal, or elements of the proposal, may be an appropriate alternative to FINRA's revised proposal."); *see also* MSRB Regulatory Notice 2015-16 at 1 ("The MSRB and the Financial Industry Regulatory Authority (FINRA) have been engaged in ongoing dialogue regarding potential rulemaking in this area.").

enormous cost, two conceptually divergent rules regarding what any new confirmation disclosure obligation should entail. FINRA and the MSRB must adopt a uniform rule.

Assuming FINRA and the MSRB agree on a uniform approach, no purpose would be served by differently worded rules that are intended to operate identically. Unfortunately, in addition to the obvious differences associated with two divergent conceptual approaches, FINRA and the MSRB continue to use different terms and organization to describe similar concepts, creating unnecessary ambiguity and compliance risk. For example, FINRA's Proposal requires disclosure of "the differential between the price to the customer and the member's Reference Price," without specifying whether such differential should be expressed as a dollar amount and/or in percentage terms, while the MSRB's Proposal requires disclosure expressed both "as a total dollar amount and as a percentage of the principal amount of the transaction."[3] FINRA's Proposal requires a reference and hyperlink to the TRACE "publicly available trading data" without specifying whether the reference and hyperlink should point to a particular TRACE page, while the MSRB's Proposal requires both a hyperlink to the Security Details page on EMMA as well as a description of the type of information available on that page.[4] Similarly, FINRA and

[3] The FINRA Proposal states, "(3) with respect to a sale to (purchase from) a non-institutional customer in a corporate or agency debt security, if 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 that equals or exceeds the size of the customer transaction: (A) the price to the customer; (B) the member's Reference Price; (C) *the differential between the price to the customer and the member's reference price*; and (D) a reference, and hyperlink if the confirmation is electronic, to the Trade Reporting and Compliance Engine (TRACE) publicly available trading data." FINRA Regulatory Notice 15-36 at 20 (emphasis added). The MSRB Proposal states, "the confirmation shall include the dealer's mark-up or mark-down from the prevailing market price for the security, *expressed as a total dollar amount and as a percentage of the principal amount of the transaction . . . .*" MSRB Regulatory Notice 2015-16 at 29 (emphasis added).

[4] The FINRA Proposal states, "(3) with respect to a sale to (purchase from) a non-institutional customer in a corporate or agency debt security, if 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 that equals or exceeds the size of the customer transaction: (A) the price to the customer; (B) the member's Reference Price; (C) the differential between the price to the customer and the member's reference price; and (D) *a reference, and hyperlink if the confirmation is electronic, to the Trade Reporting and Compliance Engine (TRACE) publicly available trading data*." FINRA Regulatory Notice 15-36 at 20 (emphasis added). The MSRB Proposal states, "(4) The confirmation for a transaction executed for an account other than an institutional account (as defined in MSRB Rule G-8(a)(xi)) *shall include a hyperlink and uniform resource locator address to the Security Details page for the customer's security on EMMA, along with a brief description of the type of information available on that page*." MSRB Regulatory Notice 2015-16 at 29 (emphasis added).

the MSRB employ different terminology to describe transactions executed by "functionally separate" trading desks[5] and positions acquired by an affiliate.[6]

Regarding potential rulemaking in this area, these types of differences create unnecessary ambiguity and can result in divergent regulatory approaches and interpretive guidance over time. While differences in the corporate and municipal debt securities markets may sometimes require differing approaches to regulation, there is no justification for the differences in terminology or formulation in this context and the Proposals should be made identical.

Moreover, as FINRA and the MSRB are aware, the Department of Labor ("DOL") is currently engaged in rulemaking that would require disclosure for certain fixed income transactions executed as principal in connection with the provision of investment advice to retirement accounts.[7] FINRA and MSRB rules will apply across retirement and non-retirement accounts. We have raised our concerns with the DOL with regard to the unworkability of their current proposal. Should the DOL proposal proceed in some form, we are hopeful that the DOL will recognize and leverage the work by FINRA and the MSRB rather than proceed on a divergent path, however, the

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[5] The FINRA Proposal states, "A member is not required to consider a principal trade where: (i) the member's principal buy (sell) transaction was executed by a trading desk that was *functionally separate from the trading desk that executed the non-institutional customer order*, including that the transactions and positions of the separate desk are *not regularly used to source the retail transactions at the other desk . . . .*" FINRA Regulatory Notice 15-36 at 21 (emphasis added). The MSRB Proposal states, "[A] dealer shall not be required to disclose the mark-up if: (a) the customer transaction was executed by a principal trading desk that is *functionally separate from the principal trading desk within the same dealer that executed the dealer purchase (in the case of a sale to a customer) or dealer sale (in the case of a purchase from a customer)* of the security; and (b) the functionally separate principal trading desk through which the dealer purchase or dealer sale was executed *had no knowledge* of the customer transaction." MSRB Regulatory Notice 2015-16 at 30 (emphasis added).

[6] The FINRA Proposal states, "A member is not required to consider a principal trade where: . . . (ii) The member's principal trade was executed with an affiliate of the member, where the affiliate's position that satisfied this trade was not acquired on the same trading day." FINRA Regulatory Notice 15-36 at 21. The MSRB Proposal states, "The term 'inventory-affiliate model' shall mean a business model in which the dealer, on an exclusive basis, acquires municipal securities from or sells municipal securities to an affiliated dealer that holds inventory in municipal securities and transactions with other market participants." MSRB Regulatory Notice 2015-16 at 30.

[7] Definition of the Term "Fiduciary"; Conflicts of Interest Rule – Retirement Investment Advice, 80 Fed. Reg. 21928 (April 20, 2015); Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, 80 Fed. Reg. 21989 (April 20, 2015). *See also* SIFMA, Comment Letter to the U.S. Department of Labor on Its Fiduciary Rule Proposal – Principal Transactions (July 20, 2015), *available at* http://www.sifma.org/issues/item.aspx?id=8589955454.

increased risk of conflict and investor confusion by the DOL's efforts highlights the importance of FINRA and the MSRB adopting a uniform rule.

II. TO MINIMIZE THE RISK OF INVESTOR CONFUSION, ANY NEW RETAIL CONFIRMATION DISCLOSURE OBLIGATION WITH SPECIFIC PRICING INFORMATION SHOULD APPLY SOLELY TO RISKLESS PRINCIPAL TRANSACTIONS.

For the reasons articulated in our initial letter, SIFMA continues to believe that any retail confirmation disclosure obligation that involves narrowly comparing the customer's trade price to another specific trade price by that same firm should apply solely to riskless principal transactions. Although the technology and compliance costs of implementation of even this riskless principal approach would be significant, disclosure of mark-ups on riskless principal trades would reduce complexity for dealers in matching trades across time in complex scenarios, relative to an approach that required reference prices to be included on non-riskless principal trades. In addition, a riskless principal approach would minimize the possibility of investor confusion from the aggregation of compensation paid by the customer with price changes due to normal market volatility. Further, limiting reference price disclosures to riskless principal trades would be most consistent with the stated initial objective of the Proposals to provide investors with reliable insight into the transaction costs associated with their fixed income trades.[8]

As we have emphasized previously, disclosure associated with riskless principal trades is most similar to the type of mark-up disclosure that the SEC has proposed on four previous occasions and would be most consistent with the recommendation in the SEC's 2012 Report on the Municipal Securities Market ("Municipal Report").[9] Notably, the SEC has found that the mark-up or mark-down in riskless principal transactions is "readily determinable" – an acknowledgement that alternative disclosure formulations would be more complicated and potentially confusing and misleading to retail investors if implemented.[10]

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[8] MSRB Regulatory Notice 2015-16 at 19. *See also* FINRA Regulatory Notice 15-36 at 12 ("Does the revised proposal alter investors' ability to obtain greater transparency into the compensation of their broker-dealers or the costs associated with the execution of their fixed income trades?").

[9] U.S. Securities and Exchange Commission, Report on the Municipal Securities Market, 148 (July 31, 2012) ("The MSRB should consider requiring municipal bond dealers to disclose to customers, on confirmations for riskless principal transactions, the amount of any markup or markdown.") [hereinafter *Municipal Report*].

[10] *Municipal Report* 148 ("Because riskless principal transactions are very similar, as a practical matter, to agency transactions, and the amount of the markup or markdown is readily

Notwithstanding our well-documented concerns associated with even a riskless principal disclosure obligation, SIFMA recognizes that FINRA and the MSRB appear to favor the adoption of a more expansive regulatory regime that would extend beyond the SEC's recommendations in this area. For this reason, we offer our additional feedback on the Revised Proposals below.

III. IF SOME FORM OF THE PROPOSALS DOES PROCEED, FINRA AND THE MSRB SHOULD EMBRACE A TWO-HOUR DETERMINATION WINDOW.

A two-hour time frame, as proposed by the MSRB, would capture nearly all of the relevant universe of "paired" firm and customer trades and is a more reasonable proxy for contemporaneous trade disclosure than a same-day window.[11] Under the MSRB's Revised Proposal, dealers would be required to disclose the mark-up on retail customer transactions "only where the dealer's same-side of the market transaction occurs within the two hours preceding or following the customer transaction."[12] In contrast to the MSRB's more targeted approach, FINRA's Revised Proposal would require "disclosure of pricing information for trades in the same security where the firm principal and the customer trades occur on the same trading day."[13] Whether FINRA and the MSRB adopt a two-hour or same-day framework, there will be operational challenges associated with delaying the confirmation process for hours after the time of the customer trade.

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determinable, confirmation disclosure of a municipal bond dealer's compensation in these circumstances should allow customers to more effectively assess the fairness of the prices provided by dealers."). *See also, e.g.*, Mary Jo White, Chair, SEC, Remarks at the Economic Club of New York, Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors (June 20, 2014) *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370542122012 ("Markups – the dealer's compensation – for these transactions can be readily identified because they are based on the difference in prices on the two contemporaneous transactions, which already must be reported promptly to FINRA and the MSRB for public posting after the trade.").

[11] Rather than relying on an interval of time between transactions as a proxy for riskless principal, FINRA and the MSRB could look to whether transactions were in fact intended to be offsetting. *See* Letter from Roger D. Blanc, Chief Counsel, Division of Market Regulation to Buys-MacGregor, MacNaughton-Greenwalt & Co. (Jan. 2, 1980), 1980 SEC No-Act. LEXIS 2851.

[12] MSRB Regulatory Notice 2015-16 at 8.

[13] FINRA Regulatory Notice 15-36 at 11.

A. A two-hour window would provide pricing information that is more representative of the market at the time of the customer transaction and already incorporates a mitigating time cushion to address gaming concerns.

To be clear, SIFMA continues to believe that any confirmation disclosure obligation with specific pricing information should apply solely to riskless principal transactions with retail investors. Moreover, as described below in Part V.B, there are several structural and operational issues with the MSRB's Revised Proposal as currently drafted. Nonetheless, a two-hour window generally would provide pricing information that is more representative of the market at the time of the customer transaction, and therefore is a better point of reference to consider the fairness and reasonableness of the price that the customer received. According to the MSRB, more than 96% of all trades that were followed by another trade in the same municipal security on the same day had the second trade occur within two hours.[14] Similarly, FINRA has found that 98% of retail-sized customer trades in corporate debt securities with same-sized corresponding principal trades occurred within 2 hours.[15] Accordingly, we believe that using a two-hour window provides the investor with all necessary information and that a broader approach could not be reasonably justified on a cost-benefit analysis – especially given the risk of increased investor confusion.[16]

In addition, a two-hour window already incorporates a mitigating time cushion to address any theoretical concerns that a firm might delay trading activity to avoid disclosure requirements. According to studies of secondary market transactions, all or nearly all of the relevant universe of "paired trades" occur within a very short window calculated to be between 5 and 15 minutes.[17] Indeed, FINRA's Proposal acknowledges that "TRACE data indicate[s] that a majority of firm and customer trades occur within 30 minutes of each other."[18] As described below, we believe that any theoretical gaming concerns are overstated and would be best addressed through required firm supervisory policies and procedures, as well as examination and enforcement. To the extent, however, that FINRA continues to harbor such concerns, a two-hour window

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[14] MSRB, Report on Secondary Market Trading in the Municipal Securities Market (July 2014) at 24 (Figure III.F).

[15] FINRA Regulatory Notice 15-36 at 7. *See also* FINRA Regulatory Notice 15-36 at 18 n.21 ("These statistics were similar for trades in agency debt securities. For example, customer trades with same-sized corresponding principal trades occurred . . . within 2 hours for more than 98 percent of the trades.").

[16] *See infra* Part V.E.

[17] MSRB, Report on Secondary Market Trading in the Municipal Securities Market (July 2014) at 24 (Figure III.F).

[18] FINRA Regulatory Notice 15-36 at 11.

would provide a considerable safeguard given that the majority of relevant activity is centered within only a 30 minute window.

B. FINRA's same-day Proposal gives undue weight to theoretical gaming concerns while sacrificing a great deal of clarity and effectiveness regarding the disclosure itself.

FINRA's same-day window would capture more trades for which the dealer has been subject to market risk. As we articulated in our earlier comments, disclosure in such circumstances may be confusing to the customer whose trade is being confirmed, as the disclosure would reflect trading profit or loss resulting from market volatility and price fluctuations. Moreover, for certain methodologies, a same-day window would create additional operational burdens associated with holding confirmations until the end of the trading day. Unnecessarily confusing and potentially misleading disclosures may in turn trigger unfounded customer complaints, which could require disclosures on a registered representative's Form U4. FINRA's Proposal does not address whether such costs and complexities have been evaluated, other than an acknowledgement that the liquidity in the fixed income market is a relevant consideration.[19] Conversely, having considered these issues, the MSRB emphasized that "the additional costs and complexities associated with the broadening of this time trigger to a full-day time period might not be justified."[20] SIFMA agrees that the additional costs and complexities to dealers, particularly those dealers that maintain inventory, as well as the risk of confusion to customers, outweigh any potential benefits of extending the window.[21]

In recommending a same-day window for determining a reference price to print on a customer's trade confirmation, FINRA appears to be making a conscious decision to address theoretical gaming concerns while at the same time sacrificing a great deal of clarity, consistency, and effectiveness regarding the disclosure itself. In particular, FINRA acknowledges that "[w]hile the TRACE data indicated that a majority of firm and customer trades occur within 30 minutes of each other," a same-day standard "will help reduce the concern that a firm might delay trading activity to avoid triggering the disclosure requirements."[22] FINRA, however, does not explain why such a same-day window is appropriate given that the capture of unrelated trades under any same-day pairing framework will reduce the relevance of the disclosure itself, increase complexity for dealers that carry inventory, and create customer confusion.

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[19] FINRA Regulatory Notice 15-36 at 15.

[20] MSRB Regulatory Notice 2015-16 at 8.

[21] *See supra* note 10.

[22] FINRA Regulatory Notice 15-36 at 11.

As SIFMA has emphasized throughout this process, our members are concerned about their ability to explain the rationale and composition of pricing disclosure to the retail investors that FINRA and the MSRB are attempting to serve. A same-day window for disclosure greatly increases these concerns. As noted above, the vast majority of trades occur well within the two-hour window proposed by the MSRB. SIFMA believes that firms are highly unlikely to materially change their trading practices merely to avoid price disclosure, as doing so would greatly increase their exposure to regulatory and market risk. Moreover, it is not sensible to impose significant costs on an entire industry because of potential abuse by a few. Such abuse could be readily addressed through examination and enforcement activity. Rather than impose a same-day window to address theoretical gaming concerns, any final rule could require firms that carry bond inventories to adopt policies and procedures, as well as corresponding surveillance systems, to monitor that traders are not delaying trading activity beyond a two-hour window with the intent to avoid triggering the disclosure requirements. This is a more direct way to address any theoretical gaming concerns, without creating unnecessary customer confusion about quality of execution that would result from an overbroad same-day framework.

The relevance of the price at which a dealer transacted in a particular bond compared to the price charged to the customer decreases over time. A two-hour window would better serve the regulatory objective and provide more clear and effective disclosure for retail customers than a same-day window. Nevertheless, we remain concerned that FINRA and the MSRB will continue to give undue weight to theoretical gaming concerns even though the marginal benefit of capturing the limited number of trades occurring outside the two-hour window is outweighed by the complexity, cost, and risk of confusion resulting from a same-day period.

IV. IF SOME FORM OF THE PROPOSALS DOES PROCEED, FINRA AND THE MSRB SHOULD ADOPT A UNIFORM RULE THAT PROVIDES FIRMS WITH THE FLEXIBILITY TO ADOPT A MATCHING FRAMEWORK, A PREVAILING MARKET PRICE FRAMEWORK, OR AN ALTERNATIVE READILY DETERMINABLE PRICE REFERENCE FRAMEWORK.

If some form of the Proposals does proceed, FINRA and the MSRB should adopt a uniform rule that provides firms with the flexibility to adopt a matching framework, a prevailing market price framework, or an alternative readily determinable price reference framework, subject to further regulatory guidance. For example, one alternative approach is for FINRA and the MSRB to provide readily determinable price references for each CUSIP, such as the VWAP over the course of each day, for dealers to include on each customer confirmation.

We recognize that one of the primary regulatory objectives associated with requiring enhanced price disclosure on retail customer confirmations is to allow investors to evaluate more readily their transaction costs. FINRA has expressed

concerns that "investors in fixed income securities currently are limited in their ability to understand and compare transaction costs associated with their purchases and sales."[23] Similarly, the MSRB suggests that "if an investor believes that a disclosed mark-up is higher than he or she might have received from another dealer, the investor may be incentivized to seek out other dealers offering lower transaction costs for future trades."[24]

We believe that a uniform rule which provides firms with the flexibility to adopt either a matching framework, a prevailing market price framework, or an alternative readily determinable price reference framework, subject to consistent application across retail customers and clearly documented policies and procedures, would provide meaningful information and investor protection in this regard. In the absence of one uniform rule, FINRA and the MSRB should each permit that same flexibility. As described below, some firms already have adopted a prevailing market price disclosure framework. However, based on a firm's business model and technology configuration, other approaches may be more reasonable to implement while still providing equally meaningful disclosure. For firms that maintain substantial balance sheets and regularly deal in fixed income securities, a prevailing market price framework would likely be costly to build while alternative methodologies may be more readily automated and would reduce the cost and risk in implementation and compliance. Given the diversity of business models among firms, FINRA and the MSRB should allow for a level of flexibility and not impose a rigid model on the entire industry that imposes disparate burdens and unnecessary costs.

A. FINRA and the MSRB should provide firms with the flexibility to adopt the matching framework or the prevailing market price standard presented in the Proposals, subject to further guidance.

The Proposals already each put forth different methodologies and as a general matter, SIFMA believes that firms should be afforded a level of flexibility to adopt the matching framework presented in the FINRA Proposal, the prevailing market price standard presented in the MSRB Proposal, or the alternative disclosure framework described in Part IV.B, as long as the chosen standard is applied consistently across retail customers and is clearly documented in policies and procedures. Nonetheless, the Proposals as currently drafted impose unnecessary regulatory risk on dealers and additional guidance regarding each approach is needed.

With respect to the matching framework, firms should be afforded the flexibility to determine the appropriate methodology for the determination of the reference price as suggested in FINRA's Proposal. In its Initial Proposal, FINRA detailed a number of specific methodologies that could be acceptable in this regard,

[23] FINRA Regulatory Notice 15-36 at 6.

[24] MSRB Regulatory Notice 2015-16 at 15.

including average weighted price, last in/first out, and closest in time. The price reference rule should outline a clear and uniform framework for firms and explicitly state that these given methodologies are permissible and will be deemed to be compliant so long as firms apply their selected methodology consistently across their retail customer base and that such methodology is clearly documented in a firm's policies and procedures. While firms may choose to seek regulatory guidance on the use of variant matching methodologies, it should be clear that certain core matching methodologies are permitted so that no unnecessary regulatory compliance risk is introduced for implementation thereof.

In proposing a prevailing market price standard, the MSRB has emphasized that firms already have processes and systems in place designed to ensure that mark-ups on principal transactions are fair and reasonable, and therefore the "prevailing market price and resultant mark-up on the customer's security should be more readily determinable."[25] We agree that, in some cases, the prevailing market price methodology would be the more readily implementable and most cost effective approach for some dealers, while still providing meaningful disclosure to retail investors consistent with the regulatory objectives. Additionally, firms that choose a prevailing market price framework would be able to calculate mark-up disclosure in real-time with the trade and would avoid any challenges associated with holding a confirmation to the end of the trading day. The flexibility to use a prevailing market price framework recognizes that some firms have developed such disclosure methodologies. For those firms that do adopt a prevailing market price methodology, we believe a rebuttable presumption for opposing trades of the same size that occur in a very narrow time window may be reasonable such that the disclosure is presumed to be the difference between the two trades in these cases. Policies and procedures would need to properly address these contemporaneous trades.

While it is true that a prevailing market price standard is used today to ensure fair and reasonable pricing to customers, a requirement to delineate an exact prevailing market price on a customer confirmation requires some additional guidance. In that context, we are primarily concerned about trades that are not contemporaneous and ensuring that there is relative consistency in approach across firms. Given the variety of indicia that may inform a determination of prevailing market price, two firms may reasonably come to different conclusions and different disclosures with similar facts, but additional guidance should reduce such variability. We are happy to engage further with FINRA and the MSRB to help define some guidance concerning how to reasonably calculate a prevailing market price.

Given the significance of confirmation disclosure, firms need comfort that they are able to satisfy fully their obligations under Rule 10b-10 under the Exchange Act for any permitted methodology. Rule 10b-10 generally requires that broker-dealers

[25] MSRB Regulatory Notice 2015-16 at 9.

provide customers with a written confirmation of a transaction disclosing certain information. Absent further guidance regarding expressly permitted matching methodologies and the determination of a prevailing market price, SIFMA is concerned that firms may be taking on material risk regarding the disclosures they include in their customer confirmations.

B. In addition, FINRA and the MSRB should provide firms with the flexibility to adopt an alternative readily determinable reference price framework.

As an alternative to the matching or prevailing market price frameworks articulated in the current Proposals, FINRA and the MSRB should also provide firms with the flexibility to adopt an alternative readily determinable reference price framework. An alternative readily determinable reference price, such as a daily VWAP, could provide for consistency and reduce complexity while also giving retail investors equally meaningful disclosure consistent with the regulatory objectives. An alternative readily determinable reference price provides useful context about the market as well as comparative pricing in the security being traded. To that end, we believe that several different price reference approaches (*e.g.*, VWAP, high/low trades) could accomplish the regulatory objective and in some circumstances may be more reasonable to implement and a more useful method of disclosure for both the dealer and its retail customers.

For example, FINRA and the MSRB could calculate an industry-wide daily VWAP for every CUSIP and publish the data relatively instantaneously at the end of the trading day. A dealer could extract the relevant CUSIP-specific VWAP for printing on individual customer confirmations. The VWAP for a CUSIP over the course of that day would serve as a meaningful price reference, providing some greater context to where the client purchased the bond in relation to market activity that day. In addition, a VWAP may in some ways be easier for dealers to explain and easier for customers to understand relative to the formulations contemplated by the existing Proposals.

The VWAP approach also has the benefit of substantially lowering the cost of implementation, as firms would not need to develop an internal calculation methodology, and instead could focus on a process to pull information on confirmations from an external source. Moreover, this approach offers firms the ability to eliminate any regulatory and compliance costs associated with reaching a reference price or prevailing market price determination, as firms would be transmitting to customers an objective and observable reference price provided by FINRA and the MSRB. In the same way, a daily VWAP would eliminate any theoretical gaming concerns for those firms choosing such methodology.

As an alternative to providing an industry-wide daily VWAP, FINRA and the MSRB could publish an industry-wide daily high/low for every CUSIP, and each dealer in turn could extract the relevant CUSIP-specific high/low for individual

customer confirmations. The readily determinable and objective nature of such statistics can offer benefits in both the implementation and clarity to customers. Such methodologies should be embraced as meaningful and valuable alternatives.

In addition, firms could be permitted to calculate an internal VWAP or some other readily determinable reference price on an individual firm basis subject to regulatory approval. Notably, FINRA's Proposal recognizes that this type of daily VWAP is an appropriate reference price in certain contexts.[26] We believe that such internal VWAP should be acceptable as a general matter.

V. ALTHOUGH FINRA AND THE MSRB HAVE ADDRESSED SOME OF THE ISSUES WITH THE INITIAL PROPOSALS, SPECIFIC STRUCTURAL AND OPERATIONAL PROBLEMS WITH THE REVISED PROPOSALS DEMONSTRATE THE NEED FOR AN ALTERNATIVE APPROACH OR SIGNIFICANT REVISION.

It is clear that FINRA and the MSRB were responsive to some of our major concerns with the Initial Proposals, however, serious structural and operational issues remain with the Revised Proposals. Accordingly, the Proposals are unworkable as currently formulated and an alternative approach or significant revision is necessary.

A. The Revised Proposals address some, but not all, of the major structural and operational issues with the Initial Proposals.

While we continue to have concerns with certain details of the Revised Proposals, SIFMA acknowledges and appreciates that the Revised Proposals address some of the major structural and operational issues that we identified with the Initial Proposals.

1. "Functionally separate" trading desks

Notwithstanding our concern that there is no justification for the usage of different terminology to describe the same concepts, SIFMA generally agrees with the approach to "functionally separate trading desks" in the Revised Proposals.[27] As we

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[26] Under FINRA's Proposal, "where there are one or more intervening principal trades between the same or greater size trades within the same trading day, the member may use an alternative methodology to determine the Reference Price." FINRA Regulatory Notice 15-36 at 22. Such methodology must be "an average weighted price of the member's same-day principal trades that either equal or exceed the size of the customer trade, or is derived from the price(s) of the member's same-day principal trades and communicates comparable pricing information to the customer." *Id.*

[27] *See supra* note 5.

emphasized in our earlier comments, the Initial Proposals failed to address whether member firms would be obliged to treat trades on a separate institutional desk in the same legal entity as reference trades for retail customer transactions, or whether they must evaluate trading activity on the proprietary desk as potential reference transactions. Given the substantive and operational complexity associated with incorporating reference data from separate institutional or proprietary desks onto retail confirmations, FINRA and the MSRB are correct to exempt such transactions in the Revised Proposals.

2. Exclusion for fixed price new issues

We agree that transactions that are part of fixed price new offerings should be excluded from the Revised Proposals.[28] The Initial Proposals were unnecessarily vague as to their intended applicability to new issues. Consistent with our earlier comments, the Revised Proposals properly note that such offerings already provide significant disclosure regarding the underwriter's compensation.[29]

3. Exclusion for transactions involving an "institutional account"

We agree that any confirmation disclosure obligation should be tailored to apply only to retail customers by using defined terms to exclude institutional and other sophisticated investors. Under the Revised Proposals, the "qualifying size" of 100 bonds or less or bonds with a face value of $100,000 or less in the Initial Proposal would be replaced with an exclusion for transactions that involve an "institutional account," as defined in FINRA Rule 4512(c) and MSRB Rule G-8(a)(xi).[30]

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[28] The FINRA Proposal states, "A member is not required to consider a principal trade where: . . . (iii) The member acquired the security in a fixed-price offering and sold the security to non-institutional customers at the fixed price offering price on the day the securities were acquired." FINRA Regulatory Notice 15-36 at 21. The MSRB Proposal states that the mark-up disclosure requirement "shall not apply to a customer transaction that is a 'list offering price transaction' as defined in paragraph (d)(vii) of Rule G-14 RTRS Procedures." MSRB Regulatory Notice 2015-16 at 30.

[29] *See* MSRB Regulatory Notice 2015-16 at 10 ("Such transactions are executed at the same publicly announced price to investors and offering documents for new issues already provide disclosure regarding underwriting fees and selling concessions.").

[30] Under FINRA Rule 4512(c), "the term 'institutional account' shall mean the account of: (1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million." Under MSRB Rule G-8(a)(xi), "the term 'institutional account' shall mean the account of (i) a bank, savings and loan association, insurance company, or registered investment company; (ii) an investment adviser registered

B. Certain aspects of the Revised Proposals require clarification or significant revision.

1. Clarify that a two-hour window would not extend to the previous or following trading day

Should the final rule adopt a two-hour window as we suggest, clarification that the window would not extend to the previous or following day is needed. As currently drafted in the MSRB's Proposal, dealers would be required to disclose the mark-up or mark-down on retail customer transactions "only where the dealer's same-side of the market transaction occurs within the two hours preceding or following the customer transaction."[31] Given that the two-hour window is intended as a proxy for contemporaneous transactions, there is no basis for such window to extend beyond the same trading day. The final rule(s) should make this explicit clarification.

Whether FINRA and the MSRB adopt a two-hour or same-day window, the beginning and end of the trading day must be clearly defined in order for firms to process confirmations. In this regard, FINRA and the MSRB should consider the existing operating hours for TRACE and the RTRS facility. Standard TRACE system hours begin at 8:00 a.m. and close at 6:30 p.m. Eastern Time, while the RTRS "Business Day" begins at 7:30 a.m. and ends at 6:30 p.m. Eastern Time. We are happy to engage further with FINRA and the MSRB regarding how to balance effectively the need for a uniform rule and the operational considerations associated with these divergent timeframes.

2. Eliminate the requirement that time of execution be printed on the customer confirmations

The MSRB's Proposal would require inclusion on all customer confirmations the "trade date and time of execution, accurate to the nearest minute."[32] FINRA's Proposal contains no such requirement. As the MSRB notes in its Proposal, Rule G-15 already provides that a dealer must either disclose the time of execution or provide the customer with a statement that the time of execution will be furnished upon written request.[33] The MSRB has not provided any basis for changing this approach. Given

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either with the Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or (iii) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million."

[31] MSRB Regulatory Notice 2015-16 at 28.

[32] MSRB Regulatory Notice 2015-16 at 22.

[33] *See* Rule G-15(a)(i)(A)(2) ("Trade date and time of execution. The trade date shall be shown. In addition, either (a) the time of execution, or (b) a statement that the time of execution will be furnished upon written request of the customer shall be shown.").

that this proposed requirement would provide no clear benefit, would be a material deviation from long-standing practice, and would impose significant implementation costs, any such requirement should be removed from any final rule(s).

3. Permit firms to adopt reasonable policies and procedures to assess what constitutes "an unusual and material change in the price of a bond"

SIFMA supports the exception in FINRA's Proposal that "would permit firms to either not disclose the reference price, or disclose with the reference price clarifying information, where the firm can demonstrate that there was an unusual and material change in the price of the bond between the time of the firm principal and the customer transactions."[34] However, other than a reference to "a material event such as a credit downgrade or breaking news," FINRA does not provide any guidance as to what would constitute "an unusual and material change" in price, and in fact excludes market volatility and price movements from consideration.[35] This exception is so narrowly drawn that, in the absence of further guidance, a dealer seeking to rely on it would in most instances be taking a significant enforcement risk. Accordingly, FINRA and the MSRB should permit firms to adopt reasonable policies and procedures to assess what constitutes "an unusual and material change in the price of a bond" in a way that is consistent across the marketplace. In particular, firms should be permitted to consider the impact of market- and sector-related developments on the price of a bond, rather than be limited strictly to CUSIP-specific developments.

4. Narrow the disclosure requirement to apply only to principal trades that are the same size or larger than the customer trade

Under the MSRB's Proposal, dealers would be required to disclose their mark-up or mark-down where they purchase a security "in one or more transactions in an aggregate trade size meeting or exceeding the size of [the customer's sale or purchase] within two hours of the customer transaction."[36] Under FINRA's Proposal, "[w]here a single principal trade is not the same size or greater than the customer trade or where there are one or more intervening principal trades between the same or greater size trades within the same trading day, the member may use an alternative methodology to determine the Reference Price."[37] Such aggregation does not occur often enough to justify the significant costs and operational complexities associated with such an approach. In this regard, FINRA and the MSRB should narrow the disclosure

[34] FINRA Regulatory Notice 15-36 at 4.

[35] *Id.*

[36] MSRB Regulatory Notice 2015-16 at 29.

[37] FINRA Regulatory Notice 15-36 at 22.

requirement to apply only to principal trades that are the same size or larger than the customer trade.

5. Provide clear and uniform guidance regarding the treatment of transactions by affiliated firms

As we emphasized in our earlier letter, transactions between affiliates should not be treated as one leg of a paired trade. SIFMA appreciates FINRA's and the MSRB's efforts to address this in their respective Proposals, but urge FINRA and the MSRB to adopt a uniform requirement that would require firms to "look through" a transaction with an affiliated broker-dealer and use that affiliate's transaction with a third party to determine the required disclosure. Under the MSRB's Proposal, a dealer operating under an inventory-affiliate model "would be required to 'look through' the transaction with the affiliated dealer and substitute the affiliate's trade with the third party from whom it purchased or to whom it sold the security to determine whether disclosure of the mark-up would be required."[38] FINRA's Proposal provides a similar but not identical requirement that would exclude trades "where the member's principal trade was executed with an affiliate of the member and the affiliate's position that satisfied this trade was not acquired on the same trading day."[39] FINRA and the MSRB should provide clear and uniform guidance regarding the treatment of inter-affiliate, dealer-to-dealer transactions under the Proposals.

6. Confirm that firms will not be required to cancel and correct confirmations due solely to a change in the reference transaction price

As we explained in our earlier letter, FINRA and the MSRB should confirm that any new confirmation requirement should not require confirmations to be cancelled and corrected due solely to a change in the reference transaction price. FINRA's Proposal confirms that, where a firm trade used to calculate the reference price is later cancelled, "FINRA would not require the firm to recalculate the reference price or re-issue a confirmation, but the firm would be permitted to do so at its discretion."[40] The MSRB's Revised Proposal suggests a "possible clarification" to its Initial Proposal that firms "would not be required to resend confirmations due solely to a change in the reference transaction to be selected, the reference transaction price, or the differential between the customer price and reference transaction price."[41] In addition, dealers would be permitted to include a disclaimer on confirmations "that the reference price and related differential were determined as of the time of confirmation

[38] MSRB Regulatory Notice 2015-16 at 10.

[39] FINRA Regulatory Notice 15-36 at 6.

[40] FINRA Regulatory Notice 15-36 at 16 n.7.

[41] MSRB Regulatory Notice 2015-16 at 24.

generation."[42] With respect to any matching framework, any final rule(s) should make this clarification explicit.

7. Permit dealers to disclose a standard mark-up schedule in lieu of the confirmation disclosure of the Proposals

As we explained in our earlier letter, certain dealers may use a standard mark-up schedule that details the compensation that the firm and its salesperson receive for retail bond transactions. As an alternative to the disclosure contemplated by the Proposals, these dealers should be given the option to disclose that schedule to customers via a link to the schedule on the confirmation or annual mailed disclosure. To be clear, SIFMA opposes the mandatory adoption of mark-up schedules generally, however, we believe this approach should be considered as an alternative option available to dealers that have established a standard mark-up schedule.

C. Any requirement to include a reference and/or hyperlink to TRACE and EMMA must be uniform, helpful to customers, and easy to implement.

If some form of the Proposals does proceed, any additional disclosure obligation related to TRACE and EMMA should be uniform, helpful to customers, and easy for dealers to implement. The MSRB's proposed configuration unfortunately has the potential to be overly complex and difficult to implement, as it would require a link customized to each security on all trades for all non-institutional accounts. Given that this specific disclosure is not the primary disclosure point, the cost of implementation should be kept to a minimum. To that end, and as an initial step, SIFMA encourages FINRA and the MSRB to adopt the approach in FINRA's Proposal, which would require a reference and hyperlink to the TRACE "publicly available trading data," without requiring such reference and hyperlink to point to a CUSIP-specific page. Accordingly, FINRA and the MSRB should specify the exact uniform resource locator ("URL") – *i.e.*, web address – that should be printed on customer confirmations. These URLs should be as short as possible so that they may be easily communicated to and entered without error by customers.[43] In addition, FINRA and the MSRB should clarify that firms will not be held responsible for any inaccurate or misleading information presented on TRACE and EMMA.

To the extent that any TRACE or EMMA reference or hyperlink must point to CUSIP-specific webpages, FINRA and the MSRB must provide shortened URLs for every CUSIP to make the disclosure more intuitive for investors, as well as easier and more succinct for the dealers to implement. In this regard, FINRA and the MSRB

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[42] *Id.*

[43] For example, a link to the URL http://emma.msrb.org/ would be intuitive for customers and simple for dealers to implement.

should develop a clear protocol whereby shortened URLs would be based on CUSIPs. Dealers, in turn, could follow such protocol for the construction of the link on the customer confirmation. Should FINRA and the MSRB pursue this approach, they should ensure that every URL remains unchanged indefinitely, such that customers will always be directed to the relevant information.

D. FINRA and the MSRB should provide examples of how required information would be expected to appear on trade confirmations.

SIFMA is concerned that FINRA and the MSRB may not have focused on the practical question of how and where the newly required confirmation disclosures could be presented within the confines of the current market's required paper-based confirmations. In particular, guidance is needed as to how such information can be provided, given the space constraints, in a manner that avoids investor confusion and the possibility of misleading investors. FINRA and the MSRB should provide specific, non-exclusive examples of how they envision such information to be included within the types of trade confirmations currently in use. To be sure, firms would require a level of flexibility given the differences in firm systems and technology configurations. Nevertheless, we believe that such an exercise can both assist FINRA and the MSRB in understanding the concerns expressed in this letter and in comments of other market participants regarding the problematic nature of attempting to include this type of information on trade confirmations, and, should FINRA and the MSRB demonstrate appropriate means of presenting such information, provide extremely useful guidance on how they expect such information to appear.

As a related matter, FINRA and the MSRB must provide uniform and clear guidance regarding the form and content of any required disclosure, including whether such disclosure should be expressed in dollar or percentage terms. As noted above, the Proposals use inconsistent language to describe the form of disclosure that would be expected to appear on trade confirmations. Under FINRA's Proposal, regarding retail customer trades, members would be required to disclose "(A) the price to the customer; (B) the member's Reference Price; [and] (C) the differential between the price to the customer and the member's reference price."[44] Under the MSRB's Proposal, disclosure of the dealer's mark-up or mark-down from the prevailing market price must be expressed "as a total dollar amount and as a percentage of the principal amount of the transaction."[45] There is no policy justification for two inconsistent approaches in this context and, should some form of the Proposals proceed, the disclosure requirement for all permitted methodologies should reflect the price to the customer, the reference price, and the differential as FINRA suggests. We believe any further configuration or representation, especially the inclusion of a total dollar amount, could lead to confusion as to what the disclosure represents.

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[44] FINRA Regulatory Notice 15-36 at 20.

[45] *See supra* note 3.

E. The costs associated with implementation of the Proposals and ongoing compliance would far outweigh the potential benefits.

As we stressed in our earlier letter, FINRA and the MSRB must consider the significant burdens on competition presented by the Proposals and whether their adoption would impede the operation of the capital markets, including the secondary market for debt securities. To this end, FINRA and the MSRB must each conduct a robust cost-benefit analysis that demonstrates that the Proposals are needed, that the costs associated with them are necessary, and that no other less burdensome alternatives would meet the objective. Such an examination would reflect that the risks of even a small reduction in retail bond market liquidity could easily injure investors far more seriously than any benefit to be gained by the Proposals.[46]

The costs and burdens associated with implementation of the Proposals and ongoing compliance would be enormous. As we described in our initial comments, preliminary assessments suggest that technology costs for introducing firms would range from $500,000 for a smaller firm to as much as $2.5 million for large diverse organizations. Clearing firms may need to expend in excess of 5,000 man hours to alter their systems. Front-end vendor licensors also expect to incur substantial costs in association with any implementation process. These initial estimates do not include any of the significant ongoing costs related to additional surveillance, personnel, and system maintenance resulting from these Proposals. The implementation and ongoing legal and compliance costs associated with the Proposals are also substantial. Implementation of far-reaching changes such as those contemplated by the Proposals requires upfront and ongoing costs related to training of personnel, revision of written supervisory procedures, ongoing compliance reviews and internal audits, explaining procedures to FINRA examiners as well as annual reviews of procedures and supervisory controls processing. FINRA and the MSRB have not addressed adequately the enormous costs that the Proposals would impose on introducing firms, clearing firms, and front-end vendors. We acknowledge that providing firms a level of flexibility among methodologies in the manner that we suggest may alleviate costs to some degree.

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[46] Several recent judicial decisions have emphasized that, under the Administrative Procedure Act, the Commission must conduct a robust cost-benefit analysis as part of any rulemaking process. *See, e.g.*, *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (finding that the Commission failed to assess the economic consequences of its rule); *American Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010) (finding that the Commission failed to define an appropriate economic baseline against which to measure the likely benefits and costs of its rule); *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005) (finding that the Commission failed to identify and consider reasonable alternatives to its rule). While we recognize the differences inherent in SEC and SRO rulemaking, we think it is important that FINRA and the MSRB justify their rulemaking with the same level of rigorous cost-benefit analysis.

As a general matter, SIFMA notes that, although FINRA and the MSRB typically have control of the timing of their proposals and can delay releasing them until they have taken whatever time they think is necessary to undertake such analyses in support of such proposals, commentators must try to generate meaningful data in the short windows typically provided by FINRA and the MSRB for submitting comments. Even assuming that market participants stand ready to begin economic analysis immediately upon a proposal being introduced, it is readily apparent that such an analysis – entailing understanding and analyzing the proposal, determining what data is relevant in addressing the proposal, gathering such data, analyzing such data, reaching conclusions on such data, and reviewing the analysis and conclusions – will almost invariably take considerably longer than the one or two months provided for by FINRA and the MSRB. SIFMA believes that FINRA and the MSRB should provide much longer comment periods – from four to six months – for proposals that entail more than a limited amount of potential costs to market participants.

F. FINRA and the MSRB must consider whether the Proposals will promote efficiency, competition, and capital formation.

Exchange Act Section 15A(b)(9) and 15(B)(2)(C) require that FINRA and MSRB rules "not impose any burden on competition not necessary or appropriate in furtherance of the purposes of [the Act]." Further, Exchange Act Section 3(f) requires the SEC, when reviewing a proposed rulemaking, to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." Consistent with these requirements, both FINRA and the MSRB have adopted frameworks for conducting economic impact assessments when engaged in the rulemaking process. [47] The frameworks require FINRA and the MSRB to consider the distributional impacts of any rule proposal, particularly with respect to efficiency, competition, and capital formation. Nonetheless, FINRA's Proposal does not address and the MSRB's Proposal contains only a brief acknowledgment of the effect of the proposed rules on efficiency, competition, and capital formation. In particular, given that larger firms have a greater ability than smaller firms to bear any implementation and ongoing costs associated with the Proposals, FINRA and the MSRB should conduct a thorough analysis regarding whether the Proposals will accelerate industry consolidation or force smaller firms from the market. The Proposals should be revised to include a detailed assessment regarding the impact of the Proposals on efficiency, competition, and capital formation.

[47] FINRA, *Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking* (September 2013); MSRB, *Policy on the Use of Economic Analysis in MSRB Rulemaking*, http://www.msrb.org/Rules-and-Interpretations/Economic-Analysis-Policy.aspx (last visited Dec. 7, 2015).

G. FINRA and the MSRB should provide for an implementation period of at least three years.

Without a clear and uniform proposal, it is difficult to provide a proposed implementation timeline. Nonetheless, given that the Proposals would require a fundamental reorientation of firm infrastructure and technology at enormous cost to the industry, our initial assessment is that FINRA and the MSRB should provide for, at a minimum, a three-year implementation period from the time of any rule filing. As detailed in our previous letter, the Proposals would require substantial system enhancements by introducing firms, clearing firms, and third-party vendors of front-end systems. The Proposals would require dealers to implement costly and complex modifications to front, middle, and back-office systems. At the onset and on an ongoing basis, firms may be required to coordinate across multiple entities in order to generate compliant confirmations. For example, certain information may be with the introducing broker, other information with the clearing broker, and other information with third-party vendors servicing either one. FINRA and the MSRB must consider fully the enormous operational and programming challenges related to the implementation of the Proposals.

Further complicating any effort to implement the Proposals is the fact that the securities industry will be consumed over the next 18 to 24 months with implementing a two-day settlement cycle (T+2), which presents its own set of challenges related to the confirmation statement delivery process. The same technology and operational experts working on implementing a shortened settlement cycle will be necessary to any effort to implement a new confirmation disclosure obligation. Given the substantial technical and programming challenges to implementation, the difficulties associated with coordinating data across various entities, and the limited resources available due to other regulatory objectives, FINRA and the MSRB should provide, at minimum, three years to implement and test such a large and highly complex information technology project. This timeframe may vary depending on the complexity of any rule and how many different groups are impacted. We ask that FINRA and the MSRB work with the industry on a proposed implementation that is reasonable and consistent with the multiple regulatory demands firms must address.

CONCLUSION

SIFMA thanks FINRA and the MSRB for the opportunity to comment on the Revised Proposals. We support the objective to provide retail investors with helpful and clear bond pricing information. To that end, we continue to believe that any new confirmation disclosure obligation with specific pricing information should be limited solely to riskless principal trades.

We emphasize that any confirmation disclosure obligation with specific pricing information must accommodate a market involving thousands of CUSIPs and a diverse

set of fixed income products representing a wide range of trading patterns, qualities, and characteristics. Should some form of the Proposals proceed, FINRA and the MSRB should adopt a two-hour reference window and should permit flexibility among several alternative methodologies to determine that price reference. As currently formulated, the Proposals lack necessary specificity, present unworkable challenges in application and operation, risk misleading the very customers they are intended to protect, and have the potential to undermine bond market liquidity. These shortcomings demonstrate the need for further revisions and guidance in the manner we suggest.

SIFMA welcomes the opportunity to discuss the Proposals, SIFMA's comments, and the various alternatives that would best serve the objective to enhance bond market price transparency for retail investors. Should you have any questions, please do not hesitate to contact the undersigned or Bruce Newman, SIFMA's outside counsel at Wilmer Cutler Pickering Hale and Dorr LLP, at 202.663.6000.

Respectfully submitted,

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Morgan Stanley

December 11, 2015

BY ELECTRONIC MAIL

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: FINRA Regulatory Notice 15-36,
Pricing Disclosure in the Fixed Income Markets

MSRB Regulatory Notice 2015-16,
Request for Comment on Draft Rule Amendments to
Require Dealers to Provide Pricing Reference
Information on Retail Customer Confirmations

Dear Ms. Asquith and Mr. Smith:

Morgan Stanley Smith Barney LLC ("MSSB") is pleased to provide comments on behalf of itself and its affiliate, Morgan Stanley & Co LLC ("MSCO" and together with MSSB, "Morgan Stanley"), to the Financial Industry Regulatory Authority's ("FINRA") Regulatory Notice 15-36 (the "FINRA Proposal") and the Municipal Securities Rulemaking Board's ("MSRB") Regulatory Notice 2015-16 (the "MSRB Proposal," and together with the FINRA Proposal, the "Proposals").

MSSB is dually registered as a broker-dealer and an investment adviser, and MSCO is a registered broker-dealer. MSSB operates one of the largest wealth management organizations in the world, with nearly $2.0 trillion in client assets as of September 30, 2015. MSSB offers personalized services to its wealth management clients through its more than 15,800 financial advisors. MSSB and MSCO maintain an extensive inventory of fixed income securities and also source securities from third parties, in each case to provide liquidity on both sides of the market to customers of both broker dealers.

Morgan Stanley continues to support FINRA's and MSRB's goal of enhancing fixed income price transparency for retail investors and appreciates the opportunity to comment on the Proposals.

Morgan Stanley generally supports the views advanced by the Securities Industry and Financial Markets Association ("SIFMA") in its forthcoming comment letter on the Proposals

(the "SIFMA Letter"). However, given the size and unique characteristics of our retail and institutional businesses and our experience in fixed income markets generally, we wish to comment on particular aspects of the Proposals:

1. The Importance of Objective Disclosure Methodology

Morgan Stanley is concerned the Proposals do not adequately provide for objectively determined disclosures and, as a result, risk causing confusion for the very investors they are designed to benefit while exposing dealers to the risk of liability if their methodology and disclosures are subsequently challenged. Morgan Stanley notes that customer trade confirmations currently contain objective, factual information, including data about the security and transaction that are obtained from third party data providers or calculated using clearly defined inputs and formulas (such as accrued interest and yield to worst). Morgan Stanley is supportive of providing additional confirm disclosure for its retail investors, but any such disclosure should be formula based and not subject to interpretation.

While the Proposals on their surface may appear to call for objectively determined disclosures, they lack the specificity and guidance necessary for that end. Even with the narrower window proposed by the MSRB, determination of an exact mark-up is challenging at best in the fixed income over the counter marketplace. This is particularly difficult for firms that maintain substantial balance sheets of continuously changing inventory and that often transact in and out of cusips in the course of their market-making activities to meet the demands of customers and counterparties. Moreover, intervening market, sector and issuer events can render a potentially contemporaneous transaction an unreliable indicator of prevailing market price. In contrast, while the FINRA Proposal advances a formulaic, objective approach, it does not offer enough specificity or establish a particular regulator-approved methodology that firms could employ consistently in compliance with any eventual rule.

Accordingly, Morgan Stanley supports the adoption of an alternative readily determined price reference framework as described in the SIFMA Letter. Specifically, Morgan Stanley believes that disclosure of VWAP and the differential as a percentage of par between VWAP and the price to the customer provide investors with valuable insight into the quality of their execution in the context of the broader market for their securities. Further, VWAP could be consistently disclosed across firms, would be easily explained to, and understood by, retail investors, would not be misleading and would be objectively determined. In addition to these benefits, we believe the cost of implementation would be lessened as VWAP could be calculated by FINRA and MSRB and imported onto confirms like other referential data is disclosed. For the same reasons, Morgan Stanley would also support other objective disclosures referenced in the SIFMA Letter, such as 'high/low' reported trade prices.

While VWAP or another readily determined price reference framework offers considerable advantages to customers and firms alike and achieves meaningful disclosure, Morgan Stanley would also support a matching framework consistent with the SIFMA Letter, provided that FINRA and MSRB adopt one or more approved objective methodologies in the Proposals. The FINRA Proposal advances a matching framework but requires more guidance and specificity for firms so they can be assured of being in compliance with any disclosure

requirements. Morgan Stanley also supports an exclusion from the disclosure requirements as described in the FINRA Letter due to an "unusual and material change in the price of a bond;" however, any such exclusion should also permit firms to factor in market- and sector-related developments in determining whether disclosures are required.

2. Time Frame for Disclosure

Consistent with the SIFMA Letter, Morgan Stanley believes a two-hour time frame for disclosure is appropriate and supported by FINRA's and MSRB's data which demonstrate that the vast majority of all "paired" trades occur within a very narrow window of time (see, for example, Section IIIA and the corresponding footnotes in the SIFMA Letter), which is well short of the two-hour window in the MSRB Proposal. Moreover, a narrower window substantially mitigates the risk of volatility and investor confusion and would reduce the likelihood firms would need to subjectively determine whether an intervening event was impactful enough to warrant not providing the disclosure.

Morgan Stanley respectfully submits that concerns around the risk of gaming in the context of a narrower window are misplaced. Considering the vast majority of paired trades occur well within the two-hour period, it seems highly unlikely firms would change trading patterns and materially increase risk exposure by holding positions longer merely to avoid disclosure, in particular considering the risk of non-compliance. Any remaining concerns about firms delaying executions can be substantially mitigated by supervisory policies and procedures (including surveillance) and regulatory examination and enforcement activities.

3. Uniform FINRA and MSRB Disclosure Rule

Morgan Stanley agrees with SIFMA and wishes to emphasize the importance of FINRA and MSRB developing a uniform, harmonized disclosure requirement. The risks presented by inconsistent requirements, the resulting investor confusion and the costs of implementation of two frameworks would greatly exceed the benefit (if any) of having discrete requirements under applicable FINRA and MSRB rules. Further, the timeline for implementing different FINRA and MSRB methodologies would significantly extend the period firms would require to conform to any eventual disclosure requirements.

4. Inter-Affiliate Transactions

Morgan Stanley appreciates MSRB's and FINRA's treatment of affiliate transactions under the Proposals, but as noted in the SIFMA Letter and above, Morgan Stanley requests a harmonized approach. Echoing our comments on the earlier MSRB and FINRA proposals, MSSB and MSCO fulfill client trades using inventory held by both dealers. The "trade" between these dealers is tantamount to a booking move across entities and should not be construed as a matched or reference transaction under the Proposals. Investors should not receive different disclosures depending upon whether their dealer utilizes the inventory of one or more affiliated entities.

5. Implementation Costs and Challenges

Finally, Morgan Stanley stresses the significant implementation costs and challenges associated with the Proposals, both for firms individually and when aggregated across the industry. These costs and burdens should be viewed in light of the broader concerns expressed above and in the SIFMA Letter and should be compared against the costs and benefits of the approaches to increase transparency in the fixed income markets suggested by Morgan Stanley and SIFMA. Specifically, a simple, consistent application of a clearly defined reference price (whether that reference price is VWAP, a matched price or a price determined from an alternate approach) that is not subject to a large number of inputs or contingencies would not only mitigate the potential for investor confusion, but would also make implementation less expensive.

Conclusion

In conclusion, rather than implement overly complex, confusing, costly and inconsistent disclosure requirements, Morgan Stanley respectfully requests FINRA and MSRB explore the alternatives suggested by Morgan Stanley and SIFMA to address the policy objectives set forth in the Proposals. In particular, Morgan Stanley urges FINRA and MSRB to develop a uniform approach to pricing disclosure which would permit firms to adopt an objective readily determined price reference framework as described above. Such a framework would provide meaningful, consistent disclosures to clients and increased transparency in the marketplace. An alternative matching framework could also address the concerns Morgan Stanley has with the Proposals, so long as FINRA and MSRB provide the necessary specificity concerning regulator-approved matching methodologies.

We appreciate the opportunity to provide comments to FINRA and MSRB on the Proposals and look forward to a continuing dialog on this important rulemaking initiative. We would be pleased to discuss any questions FINRA or MSRB may have with respect to this letter.

Respectfully submitted,

Elizabeth Dennis
Managing Director
Morgan Stanley Smith Barney LLC

DIAMANT
INVESTMENT CORPORATION

Comprehensive Portfolio Management

November 30, 2015

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

RE: FINRA Proposed Ruling 15-36

Dear Ms. Asquith,

Diamant Investment Corporation (Diamant) is making the below constructive comments regarding the above proposed ruling detailed in the FINRA Proposed Ruling 15-36 (Proposal). The reason for making these comments is that is after reading the text of this proposed rule change, it became clear that FINRA, a regulatory authority charged with creating rules for the corporate bond industry, is continuing to demonstrate excessive regulatory overreach to a properly functioning bond marketplace, without an understanding of damages the Proposal will have for the very retail customer they are claiming to help. As this Proposal is essentially identical to the 14-52 Proposal with only very minor changes, it becomes imperative that the FINRA Board take a step back from the minutia of this Proposal and grasp the enormity of what such a Proposal as 15-36 will do to the corporate bond industry.

The Corporate Bond Business

Diamant is a small, self-clearing, bond dealer that has been in business for over 40 years serving the investment needs of retail investors. I have developed considerable expertise in the retail bond business, having worked full time at Diamant, our family owned business, for over 37 years. Although the Proposal was clearly written by articulate policy makers and lawyers, it is remains very clear they have a near complete lack of understanding of the way bonds trade.

In the fixed income marketplace, business is conducted in large, but imperfect auction market. It is an auction marketplace that is dependent on bids and offers from a diverse group of bond dealers that position bonds for future sale. In the corporate bond market, bonds are not fungible, many CUSIPS trade infrequently (i.e. are not actively traded), and there are different characteristics between bond issues. There are complexities in locating and evaluating fixed income bonds that do not exist in other markets.

This auction market for fixed income bonds is completely different than transactions in the stock market. In the stock market, as little as 5,000 stocks trade in a manner where the same CUSIP can be traded on any given day in the year. With stocks, a customer order can be directed and executed on a listed stock exchange in a riskless agency transaction. It is important to recognize that bonds simply do not work this way. This is all pretty basic stuff, but

apparently this point continues to be missed when proposals like this effectively treat corporate bond trading just like a riskless agency transaction.

Many broker/dealers engage in transaction in bonds. If riskless agency trading of bonds actually worked over time for broker/dealers, then competitive market forces would force agency trading to become widespread in the bond industry. Given the characteristics of corporate bonds (as described above), effecting principal trades in the auction market place is the method that nearly every broker/dealer uses to transact business.

Despite the use of computers and various bond listing systems, the bond industry remains a fragmented auction market place where large bond dealers, mid-size bond dealers, and small bond dealers all co-exist, with each type of firm providing strength to a part of the market place. Just because this industry remains an auction market does not mean the current system is broken, or needs substantial regulatory interference in the guise of helping the customer.

Economic Baseline Assumptions

The data presented in this Proposal does not support passing this Proposal. Using recent trade data, we now know that 93% of same sized corresponding corporate bond trades occur within 10 minutes. The average price spread is 0.73%. As with any average, there are trades with larger price spreads. There is no indication that these 93% of the corporate bonds trades harmed the customer. And there may be circumstances that justify a trade with higher spreads. Such a trade may have been for a small piece (such as a 5M piece); combined with either a long maturity; or a lower quality credit that trades with larger spreads; or an infrequently traded bond. Perhaps such a trade simply required more retail costs to properly handle the customer needs. This information is interesting to learn. Yet it does not indicate any violation of FINRA rules.

Although I have no reason to doubt the integrity of the people preparing the statistics, these economic baseline assumptions are missing trade information. All these trades occurred during a period of time when the capital markets have been distorted by actions of the Federal Reserve. Interest rates have been artificially low for seven years. With the certainty of losing principal value when rates increase, smaller, professional broker/dealers like Diamant have steered customers away from buying corporate bonds. Thus trade spreads and time frames from such broker/dealers are not part of the FINRA statistics. Since firms like Diamant do not trade bonds within these short times, the absence of such firms materially trading in the time frames analyzed suggest the data presented in this Proposal does not truly reflect the entire corporate bond auction market place in a normal economic environment.

No Need For The Proposed Rule

In the section titled "Need for the Rule" the assertion is made that the need for this Proposal is because FINRA is concerned investors are limited in their ability to understand and compare transactions costs. Why is the need to understand and compare the transaction costs of a bond dealer important to a customer unless they plan on becoming a bond dealer? Over the last

several decades that I have been following the bond markets, FINRA has not reported a substantial pattern of pricing abuse within the corporate bond auction marketplace, and they would have already taken action to remedy such issues. So this Proposal is not based on a real problem with retail trades, but rather on an unproven premise that it would be somehow helpful for a bond dealer to provide a customer with the gross markup in certain bond trades. Without demonstrating a real need, FINRA is practicing regulatory overreach in creating rules to solve a problem that does not exist.

Still A Very Bizarre Line Of Reasoning

This entire Proposal is based on the premise that markups are somehow bad. This presumption has little to do with "helping" the customer with confusing partial disclosure. We all must recognize it has the feel of a politically driven effort to penalize a business sector by attempting to eliminate profits in the fixed income bond business. Which industry will be next?

There seems to be a misguided belief that securities bond dealers can continue to operate in a compliant manner in an already heavily regulated industry; can add substantive additional compliance and operational costs to attempt to adhere to this Proposal; can continue to risk capital to provide a supply of securities to their customers; and can provide associated ongoing investment securities services to their customers; all while earning little or any gross profit. This theory simply will not work in the business world.

The reasoning behind this Proposal is that by forcing disclosure of the gross trade profit of a bond dealer, customers will somehow be better informed about the characteristics of the corporate bond investment they are making. By itself this is a very bizarre line of reasoning that is not used in any other decision making in the purchase of either small or large ticket items. Again, to illustrate just a few examples:

> When a customer purchases either a new or used car, they never see the gross profit that the car manufacturer and/or the car dealer is making, as their focus properly is on securing a piece of transportation that meets their needs.
>
> When a customer renovates or purchases a house, they never see the gross profit of the builder or the individual seller, as their focus properly is on whether the location and structure is suited to their needs for shelter.
>
> When a customer purchases food at their local supermarket, they never see the gross profit in each item in their cart, as their focus is on shopping in a convenient location for quality merchandise that meets their needs of nourishment.

From an ethical viewpoint, once a business sector (like bond dealers) is forced to disclose its gross profits on a transaction, in an effort to achieve truly full disclosure, such disclosure should also be mandated on every transaction that a retail customer engages in during the

conduct of their daily activity. Prior to turning this Proposal into a regulatory ruling, FINRA should first coordinate with all regulatory entities throughout the Federal Government and force all sectors of the U.S. economy to make similar disclosures. This would have a chilling negative impact on all sectors of the U.S. economy, and would have a near universal outcry of "big brother" or "big government" impeding free market capitalism. Yet this is exactly what this Proposal as written achieves, and it creates the ground breaking precedence to affect this disclosure on other industries.

Trading with Proposed Disclosure Rules

In the corporate bond business, the retail customer needs the assistance of a professional to navigate the selection of available fixed income products. When a client buys corporate bonds, their most important decision points may include: the income stream (coupon); years until their principal is returned (maturity date); return on the investment (yield which presumably is competitive to other similar bonds); what events can cause the principal to be returned early and what is the impact (call price and yield to call); what happens to this investment when rates move (duration); what revenue streams secure the interest payment; what assets secure the principal payment; what other alternatives are available; whether this investment should be made now revisited at another time; and whether the bond fits into a customer portfolio. Successful fixed income investment decisions have always been made on these types of important information.

What continues to make this Proposal so bizarre is that FINRA now believes customers should focus their attention not on important information described above, but instead on the disclosure of a gross trade profit number that should not be terribly relevant to the overall decision to purchase a bond.

As the FINRA Board must be well aware of, typically a bond dealer uses the gross profit from principal trading firm to cover costs that include: paying the trader; the registered representative that handled the customer discussion; the manager who oversees the trading desk and retail broker; any market risks that may occur in placing bonds into firm position; the back office operations staff that clears the trade; the external clearing costs incurred by the broker/dealer; the ongoing annual custody costs of collecting income along with any calls or maturities on the bond; the compliance and audit costs to maintain regulatory compliance within the firm; the normal costs to maintain a business such as rent and communications costs; and the ability of the broker/dealer to earn a profit for its shareholders.

The unstated objective of this Proposal is to force dealers to make a lower gross profit. Of the above costs involved with a bond trade, what part of the trade should be cut out without harming the customer? If the salesperson is compensated less to communicate with their customer, or if the trader is not paid to search the market, and/or the firm no longer wants to bother holding inventory, this all seems to run counter intuitive to "helping" the customer make prudent investment decisions in buying a corporate bond. For trades that would occur with a disclosure requirement, FINRA should expect that the customer will no longer receive the

needed attention to the above critical decision points inherent in a trade, as such disclosure may reduce or eliminate the gross compensation of a dealer to provide these tasks.

Is it really helpful for a retail customer to see the gross profit printed on a bond trade? I would expect nearly every customer will call their registered representative to complain about the gross profit, regardless what the number actually is. The registered representative is not earning the gross profit, and likely is unaware of the number until after the confirmation is mailed. Why would the registered representative want to have such a conversation with their customer? In this scenario, most registered representatives will simply stop selling corporate bonds to retail customers, as it is much easier to sell other investment products with a higher sales load.

And if this gross trade profit appears on the confirmation that is received by the customer on or after settlement date, is the intent of this disclosure to permit customers to break trades because a gross profit was different than they expected? If so, then any of the specific trades that meet the disclosure requirement will have to be considered as un-firm, or incomplete transactions that may have to be reversed sometime in the future. In the future, would it not be advantageous for a customer to review trades over the past six years of disclosure, select all the trades which declined in market value, and return the trades back to the bond dealer using the reasoning the gross profit was too high on the selected trades? How would a regulator expect bond dealers to haircut their net capital for incomplete trades when the dealer does not know which trades may be returned in future periods? Clearly no bond dealer would ever want to sell bonds to customers with this type of liability.

In a recent Wall Street Journal article (October 24, 2015 page B1), a finance professor carefully picked an example of a corporate bond he felt had a high markup. On a 30M piece, he calculated a gross profit of $187.50. After a careful reading of this article, one must question his "apples to oranges" comparison of this bond trade to the ~$10 cost of a stock trade effected at a deep discount brokerage firm. Another comparison is made between the spread of a corporate bond and the bid/offering spread of a stock listed on the NYSE. Any arguments that compare exchange listed stock trading with the auction market place of corporate bond trading confirms a fundamental misunderstanding of how the corporate bond market place actually works. Thus I would discount the rationale from any academic who make such arguments.

Nonetheless, in this example, if a broker/dealer was to make the disclosure of $187.50 gross profit without explanation, how does this serve the customer? Perhaps such disclosure should detail the costs to handle the transaction to illustrate a net profit. Attempting to explain a gross profit on certain trades, versus a net profit, will hinge on the linguistic ability of the legal counsel of each bond dealer. With good lawyers, bond trades will become an event that results in both misleading and confusing customers over an irrelevant decision point.

Unintended Consequences

Smaller firms will conclude that offering corporate bonds to retail customers is not worth the added compliance costs. Diamant's proprietary back office system currently handles all

customer functions related to the purchase or sale of corporate bonds. Diamant also has sufficient regulatory compliance to monitor corporate bond activity under existing regulatory rules. Yet this time tested, compliant system does not have the ability to link separate principal trades to another. It would be a major undertaking in terms of operational and software costs to re-build a back office system that could identify transactions subject to disclosure, and then place disclosure information specific to that particular trade on the confirmation. In addition, there are additional regulatory compliance costs of creating special written procedures to identify trades that would require gross profit disclosure, legal costs to prepare prudent disclosure text, along with the ongoing compliance effort to demonstrate adherence to this unprecedented trade policy and procedures.

As Diamant cannot justify the added operational costs to rebuild a back office system, the only way to comply with this Proposal is to prohibit any retail trades that fall under this Proposal as currently written. This is not a decision we take lightly, as we have been offering retail customers the ability to trade corporate bonds since 1974. Our decision to prohibit certain retail trades in corporate bonds will be based solely on this FINRA ruling.

When a seasoned broker/dealer makes such a decision as the only way to comply with this Proposal, it is easy to envision a marketplace where retail corporate bonds will be concentrated in even fewer large institutions. Concentrating trading to a handful of firms places these firms firmly in the "too big to fail" category. This means that the new definition of a fair and orderly auction marketplace will have less competition with fewer smaller firms participating. This is contrary to the concept of capitalism, but this clearly will be the outcome of this ruling, and the FINRA Board must recognize this outcome when casting their votes.

Experienced corporate bonds traders will leave the broker/dealer business. Trading will be handled by a small number of less experienced traders. As volumes pick up and trades are concentrated among a handful of firms, we should all expect more pricing errors by the remaining overworked traders. With an auction marketplace that may move towards an electronic bulletin board with fewer bids and offerings, the likely scenario is that an institutional type of customer will evolve that is not regulated by FINRA. Such an entity will use the electronic bulletin board to provide the needed liquidity for the retail customers at spreads that will benefit the institutional customer, not the retail customer.

The remaining broker/dealers handling corporate bonds will be focused on demonstrating the soundness of their compliance systems and procedures instead of the focusing on the retail customer, and will simply trade whatever is available on the electronic bulletin board. This unintended negative impact will be very beneficial to the professional traders not regulated by FINRA. As corporate bonds will then be essentially priced and offered by professional traders that are unregulated by FINRA, customers will likely pay more for the bonds regardless of what gross profit disclosure appears on a confirmation. Thus this Proposal is a no-win situation, in that the broker/dealer incurs great economic costs, potentially harms customer relationships, and the customer in the end does not gain any of the perceived benefits intended by the regulators.

A Better Time Frame

If FINRA finds itself in a political position where it need to show some action, then FINRA should design a disclosure timeframe based on its own research set forth in this Proposal. If 93% of same sized corresponding corporate bond trades occur within 10 minutes of each other, and FINRA decides to negatively impact such trading, then disclosure should occur on principal trades where matching buy and sell trades occur in this time frame. Instead an unworkable 1 day time frame from the perspective of our back office system, this disclosure timeframe should be 10 minutes. Or it could be 30 minutes, 1 hour, or even 2 hours. Any of these timeframes cover the trading identified in the Proposal. The benefit of these shorter timeframes is that small businesses, like Diamant, would be able to set up a manual review process in the back office to identify trades subject to disclosure. The shorter time frame would make it possible for smaller firms to set up procedures that use existing back office systems to achieve regulatory compliance with such a Proposal. By keeping compliance and software costs manageable, smaller firms could become, or remain active, in the business of trading corporate bonds.

Conclusion

After reviewing the Proposal and alternatives, FINRA needs to recognize this Proposal will do more harm than any good. The disclosures will clearly mislead and confuse retail investors to a degree that cannot be remedied by education, explanations, or descriptive documents accompanying a confirmation. Harming the relationship between the customer and the bond dealer, and having bond dealers reduce or eliminate retail trades, all for the sake of this misguided Proposal, simply does not add any benefit to the retail customer.

The auction marketplace has many intertwined industry participants that include retail customers; institutional customers; corporate bond dealers that trade mainly with other corporate bond dealers; and corporate bond dealers that trade mainly with their customers. All these participants within this large auction market will be adversely impacted. The larger harm will come from the auction marketplace having limited liquidity from fewer broker/dealers, or liquidity from professional institutions not subject to FINRA rules. These are very realistic outcomes from this Proposal.

To continue to maintain an orderly and regulatory compliant market in corporate bonds, FINRA must recognize the complexity within the entire fixed income marketplace, review the alternatives of enforcing existing rules, focus on firms that may fit a pattern of having a material price difference on trading corporate bonds, and commit to taking no action on the entire Proposal.

Yours truly,

Herbert Diamant
President

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
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OFFICE OF THE
INVESTOR ADVOCATE

December 11, 2015

Submitted Electronically

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RE: MSRB Regulatory Notice 2015-16
Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers

RE: FINRA Regulatory Notice 15-36
Request for Comment on Revised Proposal Requiring Confirmation Disclosure of Pricing Information in Corporate and Agency Debt Securities Transactions

Dear Mr. Smith and Ms. Asquith:

Pursuant to Section 4(g)(4) of the Securities Exchange Act of 1934 ("Exchange Act"), the Office of the Investor Advocate[1] at the U.S. Securities and Exchange Commission ("Commission" or "SEC") is responsible for, among other things, analyzing the potential impact on investors of proposed rules of self-regulatory organizations ("SROs").[2] In furtherance of this objective, we routinely review significant rulemakings of the Municipal Securities Rulemaking Board ("MSRB" or the "Board") and the Financial Industry Regulatory Authority ("FINRA"). We also make recommendations and utilize the public comment process to help ensure that the interests of investors are given appropriate weight as rules are being considered. As required by law, we report to Congress regarding our objectives and activities, which includes a summary of the recommendations we make and the responses to those recommendations.[3]

[1] This letter expresses solely the views of the Investor Advocate. It does not necessarily reflect the views of the Commission, the Commissioners, or staff of the Commission, and the Commission disclaims responsibility for this letter and all analyses, findings, and conclusions contained herein.
[2] 15 U.S.C. § 78d(g)(4).
[3] 15 U.S.C. § 78d(g)(6).

As indicated in our Report on Objectives for Fiscal Year 2016, our Office is currently focused on municipal market structure and any corresponding reform initiatives that may impact investors.[4] Thus, we appreciate this opportunity to provide comments in regard to MSRB Regulatory Notice 2015-16, Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers ("MSRB Notice 2015-16"), and FINRA Regulatory Notice 15-36, Pricing Disclosure in the Fixed Income Markets ("FINRA Notice 15-36").

I. Background

Currently, broker-dealers are required to provide retail customers with confirmation statements following fixed income transactions, but they are under no regulatory obligation to include detailed pricing information on those trade confirmations. We are not aware of any regulatory barrier preventing firms from providing enhanced and effective pricing disclosures to their retail customers on a voluntary basis. Nevertheless, current industry practices only satisfy broker-dealers' regulatory obligation to investors, and the resulting confirmation statements generally provide no more than the price that the customer paid or received for a fixed income security. Because industry practices have not addressed the longstanding problem of transaction transparency, retail investors remain disadvantaged by the lack of information they receive in confirmation statements. As a result, a regulatory solution appears necessary.

Previous Proposals

Previously, the MSRB and FINRA requested comment on related draft rule proposals, MSRB Regulatory Notice 2014-20 and FINRA Regulatory Notice 14-52. These proposals generally were consistent with each other and were designed to work in tandem to provide retail investors with better price transparency in corporate and municipal bond transactions.

The draft amendments for MSRB Regulatory Notice 2014-20 would have "require[d] dealers to disclose on the customer confirmation the price to the dealer in a 'reference transaction' and the differential between the price to the customer and the price to the dealer for same-day, retail-size principal transactions."[5] The MSRB defined the "reference transaction" as one in which the dealer purchases or sells the same security on the same date as the customer trade.[6] The proposed rule would have required dealers to "calculate and disclose the difference in price between a reference transaction disclosed on the confirmation and the price to the customer receiving the confirmation."[7] The proposed disclosure requirement would have applied to transactions involving 100 or fewer bonds or bonds in a par amount of $100,000 or less.[8]

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[4] *See* Office of the Investor Advocate, Report on Objectives for Fiscal Year 2016, June 30, 2015, http://www.sec.gov/advocate/reportspubs/annual-reports/sec-office-investor-advocate-report-on-objectives-fy2016.pdf.
[5] MSRB, Regulatory Notice 2014-20, Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations, at 1 (Nov. 17, 2014), http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-20.ashx?n=1.
[6] *Id.* at 8.
[7] *Id.* at 8-9.
[8] *Id.* at 9.

The draft amendments for FINRA Regulatory Notice 14-52 took a very similar approach. FINRA proposed that "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 would be required."[9] FINRA's proposal defined the term "qualifying size" as a transaction of 100 bonds or less or bonds with a face value of $100,000 or less.[10] The proposed customer confirmation disclosure would have included the price to the customer, the price to the member of a transaction in the same security, and the differential between those two prices.[11]

We supported these steps of the MSRB and FINRA to improve the availability of pricing information and concurred, generally, with the goals underlying both MSRB Regulatory Notice 2014-20 and FINRA Regulatory Notice 14-52.[12] We encouraged the MSRB and FINRA to adopt their respective proposed amendments because we believe that retail investors would benefit from the inclusion of additional pricing transparency on their customer confirmations.[13] We indicated that disclosing the same-day price reference information would provide retail investors with more effective tools to evaluate their transactions and the quality of service provided.[14] However, after receiving public comment, the MSRB and FINRA issued revised proposals instead of adopting the rules as proposed.

Current Proposals

FINRA Regulatory Notice 15-36 retains the same basic approach as the prior FINRA proposal. If a firm sells to a customer as principal on the same day it buys the security from another party, the firm would be required to disclose on the customer confirmation the price to the customer, the price to the firm of a same-day trade (reference price), and the difference between the two prices.[15] However, the disclosure requirement would now only apply to bond trades on behalf of non-institutional accounts, no matter the size of the trade.[16] In addition, FINRA's new proposal would allow for alternative calculation methods for more complex trade scenarios and would permit member firms to provide clarifying information when there has been a material change to the price of a security between the reference transaction and the customer transaction.[17] It also would require member firms to include a hyperlink to relevant Trade Reporting and Compliance Engine (TRACE) data on the customer confirmation.[18]

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[9] FINRA, Regulatory Notice 14-52, Pricing Disclosure in the Fixed Income Markets, at 3 (Nov. 17, 2014), http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_14-52.pdf.
[10] *Id.*
[11] *Id.* at 1.
[12] *See* Comment Letter, Rick A. Fleming, Investor Advocate, SEC, *RE: MSRB Regulatory Notice 2014-20, Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations* (Jan. 20, 2015), http://www.msrb.org/RFC/2014-20/USSEC.pdf; *see* Comment Letter, Rick A. Fleming, Investor Advocate, SEC, *RE: FINRA Regulatory Notice 14-52, Request for Comment on Pricing Disclosure in the Fixed Income Markets* (Jan. 20, 2015), http://www.finra.org/sites/default/files/notice_comment_file_ref/SEC.pdf.
[13] *Id.*
[14] *Id*.
[15] FINRA, Regulatory Notice 15-36, Pricing Disclosure in the Fixed Income Markets, at 1 (Oct. 12, 2015), http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-15-36.pdf.
[16] *Id.* at 3. As noted above, qualifying size was defined as 100 bonds or less, or face value of $100,000 or less.
[17] *Id.*at 3-4.
[18] *Id.* at 5.

In contrast, MSRB Regulatory Notice 2015-16 takes a significantly different approach from the earlier MSRB Regulatory Notice 2014-20. The new proposal would require customer confirmations to disclose the "mark-up" for principal transactions when the dealer transacts in a municipal security in a specified trade size on the same side of the market as the customer.[19] Under the proposed new calculation, the security's mark-up would be the difference between the price to the customer and the "prevailing market price" for the security at the time of the customer's transaction.[20] Moreover, under the proposed amendment, the dealer's responsibility to disclose the mark-up would be triggered only when the dealer engaged in its own same-side transaction within two hours of the customer transaction.[21] Transactions occurring the same day but outside of that two-hour window would not be subject to mandatory pricing disclosure.[22]

In addition, the new MSRB proposal would incorporate changes similar to those in the new FINRA proposal. For example, MSRB Regulatory Notice 2015-16 would require mark-up disclosure for "non-institutional" account transactions, which is already defined within the MSRB rules, as opposed to transactions of a certain size.[23] Further, it requires dealers to disclose a hyperlink and URL address to the "Security Details" page for the customer's security on the MSRB's Electronic Municipal Market Access (EMMA) service, along with a brief description of the type of information available on that page.[24]

FINRA and the MSRB both propose new exceptions to the required pricing disclosure. Neither would require disclosure of reference pricing in transactions related to offerings of new issues. [25] Additionally, each would provide exceptions for certain transactions involving functionally separate trading desks. [26]

II. Evaluation

As an initial matter, we believe investors would be poorly served by pricing disclosures that are different for corporate bonds as compared to municipal bonds. To avoid investor confusion, it is important for FINRA and the MSRB to adopt consistent rules related to confirmation disclosure. Toward that end, we submit this single comment letter in response to both proposals, and we suggest which of the competing ideas should be adopted by both MSRB and FINRA.

Timeframe

As noted above, FINRA proposes to require disclosure when the initial and subsequent transactions occur on the same trading day.[27] The MSRB, however, has proposed to shorten the relevant

[19] MSRB, Regulatory Notice 2015-16, Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers, at 1 (Sept. 24, 2015), http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2015-16.ashx?n=1.
[20] *Id.* at 8.
[21] *Id.*
[22] *Id.*
[23] *Id*. at 9 n.25; *see also* MSRB Rule G-8(a)(xi) (defines institutional account).
[24] *Id.* at 12.
[25] *Id.* at 9-10. *See supra* note 15, at 3; *see supra* note 19, at 10.
[26] *See supra* note 15, at 3; *see supra* note 20, at 11.
[27] *Supra* note 15, at 2.

window of time to two hours on either side of the customer trade.[28] According to the MSRB, its revised window would still require mark-up disclosure for at least half of all retail-sized customer trades in the secondary market.[29]

We strongly oppose the proposed two-hour window. We believe the minimum window of time for disclosure should be the full trading day. Although dealers often trade within two hours under existing rules, dealers could easily adjust their behavior to avoid the new disclosure requirements by trading a few minutes outside of the proposed two hour window. Therefore, current trading behavior is not necessarily indicative of trading behavior that will occur if the revised proposal is implemented.

Disclosure avoidance would be much more difficult under the timeframe in the FINRA proposal, which requires disclosure for transactions occurring on the same trading day. A dealer takes on much greater balance sheet risk by holding inventory overnight, which would deter dealers from separating transactions in order to avoid disclosure. Thus, we encourage the MSRB to forgo the proposed two-hour window. At a minimum, both FINRA and the MSRB should require pricing disclosure for transactions occurring within the same trading day.

Mark-Up vs. Reference Price

Although we oppose the MSRB's proposal to shorten the relevant trading window to two hours, we support moving forward with mark-up disclosure as described in the new MSRB proposal. Initially, we supported the MSRB's original proposal for price reference disclosure because it was a significant improvement over the *status quo*. In addition, the price reference proposal appeared to have the advantage of simplicity, meaning that the required disclosures would be relatively easy for dealers to ascertain. For similar reasons, we supported the original FINRA proposal for price reference disclosure.

From the investor perspective, however, there are advantages to the new MSRB mark-up proposal. Admittedly, it may lead to disclosure of a smaller cost to investors under certain circumstances. For example, if a dealer purchases a security and there is a significant positive market move prior to the resale to a retail customer, the amount of the mark-up would only be the difference between the price of the resale and the "prevailing market price" at the time of the resale, instead of the full difference between the original purchase and the subsequent resale. However, the MSRB proposal provides investors with the relevant information about the actual compensation the investor is paying the dealer for the transaction. It reflects market conditions and has the potential to provide a more accurate benchmark for calculating transaction costs.[30]

Importantly, we note also that the calculation of a true mark-up, once established under these rules, need not be limited to a single trading day. After the systems are in place for disclosing mark-ups on same-day transactions, dealers may decide for competitive reasons to disclose mark-ups on all transactions. Moreover, FINRA and the MSRB could choose to require disclosure beyond the one day window after assessing the implementation of the new rules. In contrast, a price reference disclosure model does not account for intervening market events that affect the value of the bond during the lag between the reference transaction and the customer transaction, so the disclosure becomes less

[28] *Supra* note 19, at 8.
[29] *Supra* note 19, at 8 n.22.
[30] It is our understanding that the process for calculating mark-up under the MSRB revised proposal may build upon existing systems. To that end, it may be easier for industry to implement disclosure under the MSRB's revised proposal.

meaningful as the window for disclosure increases. Thus, for disclosure of pricing information beyond a one day window, a mark-up model could serve as a better framework than a price reference model.

Although we support a move to disclosure of a mark-up that is based upon a prevailing market price, we are concerned with potential manipulation of the prevailing market price calculation. Errors in the calculation, whether intentional or not, could significantly alter the information provided to investors. With this in mind, we encourage the MSRB and FINRA to monitor carefully the industry's implementation of the rules to ensure that dealers appropriately determine the prevailing market price.

The MSRB proposes to express the mark-up as both a total dollar amount and percentage of the principal amount of the customer transaction. FINRA's proposal would disclose a differential only as a numeral. We believe that disclosing a mark-up as a total dollar amount and a percentage would more effectively enable retail investors to evaluate their transaction costs and monitor the quality of service provided by dealers. Thus, we support the MSRB approach.

Functionally Separate Trading Desk Exception

Both the MSRB and FINRA revised proposals include an exception for transactions involving "functionally separate" trading desks. Although we do not oppose an exception of this nature, both proposals could be strengthened by incorporating greater precision or guidance relating to the meaning of "functionally separate." For example, would FINRA anticipate applying similar standards to those that it currently employs when evaluating whether broker-dealer self-trades are *bona fide* or fraudulent "wash sales" under Supplementary Material .02 to FINRA Rule 5210, or does FINRA believe that a different standard would be appropriate here?[31] To avoid the possibility of such an exception becoming a loophole or blanket exception, we strongly encourage both the MSRB and FINRA to provide robust guidance surrounding the meaning and requirements concerning functionally separate trading desks.

We also believe the final rules should incorporate the strongest features of both proposals. Thus, at a minimum, a 'functionally separate' trading desk exception should require that the trading desks through which transactions are made have no knowledge of the customer transaction and that the transactions and positions of the separate desk must not regularly be used to source retail transactions at the other desk.

III. Conclusion

We appreciate the MSRB's and FINRA's acknowledgement of the information disparity inherent in fixed income market transactions, and we support your corresponding efforts to address retail customers' information disadvantage by increasing price transparency and the availability of pricing information. While we regard both proposals as improvements upon the *status quo*, we believe that combining the MSRB's mark-up disclosure methodology with FINRA's same day window would best serve the interest of investors. We also believe that the rules must be enforced rigorously to prevent manipulation of the information provided to investors.

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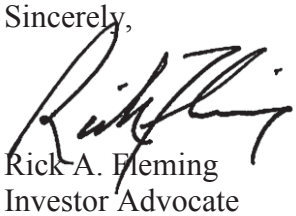
[31] *See* Order Approving Proposed Rule Change, as Modified by Amendment No. 1, Relating to Self-Trades and FINRA Rule 5210, Exchange Act Release No. 34-72067 (May 1, 2014) [79 FR 26293 (May 7, 2014)], at n.12 ("Transactions that originate from unrelated algorithms or from separate or distinct trading strategies, trading desks, or aggregation units that are frequent or numerous may raise a presumption that such transactions were undertaken with the intent that they cross and may, therefore, be intended as manipulative or fraudulent.").

Such changes could have a significant impact on the behavior of dealers and individual investors. Individual investors engaged in retail-size trades will be better equipped to evaluate the transaction costs and the quality of service provided to them by their dealers. This, in turn, should promote competition and improve market efficiency among dealers. The changes will help ensure that the prices and markups are appropriate in light of the market for the particular security.[32]

Should you have any questions, please do not hesitate to contact me or Senior Counsel Ashlee Connett at (202) 551-3302.

Sincerely,



Rick A. Fleming
Investor Advocate

cc (electronically): Lynnette Kelly, Executive Director, MSRB
Robert Fippinger, Chief Legal Officer, MSRB
Michael Post, General Counsel – Regulatory Affairs, MSRB
Patrick Geraghty, Vice President, Market Regulation, FINRA
Cynthia Friedlander, Director, Fixed Income Regulation, FINRA
Andrew Madar, Associate General Counsel, FINRA

[32] *Supra* note 5, at 7.

Consumer Federation of America

December 11, 2015

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, Virginia 22314

Re: FINRA Regulatory Notice 15-36; MSRB Regulatory Notice 2015-16
Pricing Disclosure in the Fixed Income Markets

Dear Ms. Asquith and Mr. Smith:

I am writing on behalf of the Consumer Federation of America (CFA)[1] regarding FINRA's and MSRB's revised proposals to require confirmation disclosures for retail fixed income transactions. In January 2015, CFA expressed its strong support for FINRA's and MSRB's initial proposals to require heightened confirmation disclosures, which we thought provided critical cost information that would benefit retail investors significantly.[2] After receiving feedback, FINRA has proposed certain technical adjustments to its proposal that would improve the rule's workability without undermining the regulatory goals of allowing retail investors to make more informed investment decisions and fostering increased price competition in fixed income markets. However, the same cannot be said for MSRB's revised proposal, which would allow firms to easily evade their confirmation disclosure requirements, thus undermining the goals the disclosures are seeking to promote.

While regulatory coordination and consistency are desirable goals, they must not be used as justifications for weakening crucial investor protections. Toward this end, if both SROs favor a coordinated approach, they should finalize a rule that closely tracks FINRA's revised proposal, not the MSRB's.

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[1] CFA is a non-profit association of nearly 300 national, state, and local pro-consumer organizations. It was formed in 1968 to represent the consumer interest through research, advocacy and education.

[2] FINRA Regulatory Notice 14-52; MSRB Regulatory Notice 2014-20, http://consumerfed.org/pdfs/FINRA-MSRB-proposed-rules-01-20-2015.pdf

I. FINRA's revised approach requiring disclosures for same-day transactions still achieves the goals that these disclosure are intended to promote, while MSRB's revised approach requiring markup disclosures based on a narrow two hour timeframe undermines the goals these disclosures are intended to promote. MSRB must return to a same-day transaction approach if it hopes to provide retail investors with critical cost information.

FINRA's revised proposal refines without undermining its initial proposal to require firms to disclose additional pricing information for retail customer trades in corporate and agency debt securities. As in the initial proposal, firms that buy (sell) as principal with their customers in corporate and agency debt security transactions and on the same day sell (buy) the same securities must disclose on their customer confirmations the price to the customer, the price to the firm of the transaction in the same security, and the differential between those two prices.

Reiterating our previous comments, we strongly support requiring disclosure of pricing information for all trades in the same security on the same day of trading rather than limiting disclosure to riskless principal markups. Requiring disclosure for all same-day trades would allow for a more mechanical analysis by firms which, in turn, would make it easier for investors to compare transaction costs across firms. Disclosing riskless principal markups, on the other hand, would reduce the comparability of transaction cost information across firms. Because what is considered a riskless principal markup is susceptible to varying and often arbitrary interpretations, using a riskless principal markup standard could result in inconsistent markup calculations.

Requiring disclosure for all same-day trades would also decrease the possibility of evasion, as this time-frame is broad enough to capture the vast majority of trades that are currently made on a matched basis or can reasonably be expected to be made under the rule. Requiring disclosure for a narrower window, however, would create incentives for firms to hold positions long enough to avoid their disclosure obligations and, perversely, encourage firms to remain exposed for longer periods throughout the day. As a policy matter, a rule that requires enhanced disclosure should neither be gameable nor encourage risky behavior. FINRA's same-day trading approach achieves those goals, though we encourage FINRA to continue to monitor trading practices after the rule is adopted to ensure that the rule is not being gamed.

In contrast, it is difficult to see how MSRB's revised approach requiring disclosure of markups only for dealer trades that occur within two hours of a customer's transaction achieves any sensible or meaningful policy goals. If, in order to evade the rule's requirements, a significant number of firms hold onto positions beyond the 2 hour window, retail customers would not receive pricing disclosure and would be no better off than they are today. That is a predictable outcome of the rule. While saying that it is not proposing to use a two-hour timeframe to define what a "riskless principal" transaction is, that is effectively what MSRB is doing for purposes of this proposal. And, by saying that two hours is "sufficient to cover transactions that could be considered 'riskless principal' transactions under any current market understanding of the term," it is implying that anything longer might not be considered "riskless." As with other approaches to considering what a riskless principal transaction is, this two-hour approach is arbitrary, as it is based neither on function nor on known or expected market dynamics.

The two-hour timeframe also would create incentives for firms to hold positions long enough to evade the rule's disclosure requirements. Firms that currently match trades in under 30 minutes would have an incentive under the rule to delay their trading for 2 hours and 1 minute to avoid their

disclosure obligations. So, while *current* TRACE and EMMA data indicate that the vast majority of same day retail-size match trades occur within 30 minutes of each other, regulators should not infer that those trading behaviors would remain under the rule. And, while FINRA's proposal states that the revised FINRA approach and the MSRB's approach would produce similar outcomes "in many circumstances," that statement is reflective of what the outcomes would be under current market conditions, not under different incentives that would likely alter trading behavior. Further, as FINRA's proposal makes clear in footnote 31, MSRB's approach is likely to be much narrower in practice than FINRA's approach and result in less disclosure to retail investors. According to TRACE data from the first quarter of 2015, for example, 38 percent more retail-size trades would have received FINRA's proposed reference price information than had those trades been limited to riskless principal trades. Thus, even under current market dynamics, a riskless principal markup approach would result in retail investors' receiving less price disclosure than they would under a same-day approach. Instituting a riskless principal markup approach that changes firms' incentives to hold past the point they are required to disclose would result in even less disclosure than that.

The two-hour timeframe would also encourage firms to remain exposed for longer periods throughout the day than they might otherwise be. Under firms' current regulatory incentives, the threat of firms' being exposed to disadvantageous market movements mitigates firms' incentives to remain exposed longer than necessary. However, this rule introduces a new incentive, avoiding disclosure, which counteracts that threat. In most circumstances, holding onto positions for a few extra hours will not materially increase firms' risk profiles, which may push them to holding positions longer. However, should there be material changes to the prices of securities during an unexpected period of high volatility, which will inevitably happen from time to time, a firm's exposure could result in serious losses to the firm. It is inappropriate for regulators to introduce incentives that encourage such risky behavior, even if the circumstances that can lead to serious losses occur rarely.

It appears from footnote 19 in MSRB's reproposal that the MSRB has revised its approach in response to substantial broker-dealer industry opposition to MSRB's and FINRA's initial proposals. Specifically, MSRB cites to comments by the Securities Industry and Financial Market Association (SIFMA), Morgan Stanley Smith Barney, LLC and Wells Fargo Advisors, LLC claiming that markup disclosure on riskless principal transactions "could achieve similar or greater benefits than the pricing reference proposal but at significantly lower cost" and comments by Bernardi Securities, Financial Services Roundtable (FSR) and Hilliard Lyons, favoring limiting any disclosure to riskless principal transactions. But the role of regulators is not simply to take their cues from members of industry, who have obvious incentives to curtail the information they provide to investors. The role of the MSRB, as it notes in its mission statement, is to "protect investors, municipal entities and the public interest by promoting a fair and efficient municipal market, regulating firms that engage in municipal securities and advisory activities, and promoting market transparency."

Despite this investor-focused mission, nowhere in its comments does MSRB even acknowledge CFA's initial comment expressing strong support for the same-day pricing reference approach, much less respond to our comments expressing support for that approach. Instead, MSRB merely adopts the same view as the industry "based on careful consideration of all of the comments received on the pricing reference proposal…" The inherent lack of balance in the regulatory process, which results from the fact that industry comments will *always* outnumber comments from investors and investor advocates, is made worse when regulators choose simply to ignore the investor comments they do receive. By focusing exclusively on industry objections and ignoring investor benefits of its original approach, MSRB has proposed an approach that would allow firms to disclose

pricing information to the extent it is most conducive to those firms, rather than what is most conducive to market integrity and retail investor protection.

For the above reasons, we urge MSRB to return to its original approach, which better protects investors, does more to promote market transparency, and more closely tracks FINRA's approach requiring disclosures for same-day transactions.

II. FINRA's and MSRB's replacement of a size-based disclosure threshold with a retail customer standard better captures trades that are likely to most benefit from enhanced price disclosures.

In their initial proposals, FINRA and MSRB used a size-based requirement to trigger disclosure requirements, whereby disclosure would apply to a transaction with a customer to purchase or sell 100 bonds or less or bonds with a face value of $100,000. While we understood that such a size-based standard had the potential to be both over-inclusive, in that it might capture small institutional trades, and under-inclusive, in that it might not capture large retail investor trades, we still thought it was a reasonable approach to capturing those trades that are retail in nature and would most benefit from enhanced price disclosures. In our initial comments, we urged FINRA and MSRB to continue to monitor market activity in relation to the definition of "qualifying size" to determine whether that standard should be modified.

The revised proposal replaces the "qualifying size" threshold with a retail customer account standard. This strikes us as a better approach toward capturing trades that are likely to benefit most from enhanced price disclosures. Under the revised approach, all retail transactions will receive confirmation disclosures regardless of how large they are, and no institutional transactions will receive confirmation disclosures regardless of how small they are. This is an appropriate distinction for the purposes of this rule, as institutional investors are typically more sophisticated and better-informed than retail investors and, as a result, should already understand the transaction costs they are paying.

III. The proposed exemptions to the revised proposals are, by and large, reasonable, with a few exceptions. FINRA and MSRB must ensure that those exemptions are not used to evade disclosure obligations.

FINRA has proposed to allow firms the flexibility to establish a reasonable alternative methodology for determining the reference price when more complex trades are made. Under FINRA's proposed approach, if one or more intervening principal trades of a different size are made, firms have two options. They can employ the average weighted price of the firm trades that equal or exceed the size of the customer trade, or the price of the last same-day trade executed as principal by the firm prior to the customer trade (or closest in time if executed after). Further, the firm must consistently apply that methodology across the member's retail customer base and clearly document that methodology in written policies and procedures.

Allowing firms to choose between these options, but requiring firms to consistently apply whichever methodology they choose and clearly document that methodology in written policies and procedures, would constrain firms from adopting novel and complex methodologies on the fly that render their calculations meaningless, inaccurate, or deceptive. We urge FINRA to retain these requirements in its final rule, and we urge MSRB to adopt them as well, alongside its return to the

original approach proposed. Failing to do so would create a huge loophole, enabling firms to evade their responsibility to provide meaningful, accurate, and consistent price reference calculations.

FINRA has also proposed to allow firms to elect whether to disclose the reference price for transactions in which there are material changes to the price of a security or to disclose instead the reference price together with a statement explaining such price change. Under the proposal, firms could elect not to disclose after documenting and demonstrating that a material change has occurred.

It is not clear how this exemption would work in practice, first, because it's not clear what standard a firm would need to meet to document and demonstrate that a material change has occurred, and second, because "material change" is not defined. The only guidance that is provided is that this provision could be used when there is a material change in the market price, due to, for example, a credit downgrade or breaking news regarding the obligor, and that this exemption is not intended to be used when the price of the security has changed due to normal price fluctuations or general market volatility. While a credit downgrade is a concrete occurrence that is not likely to occur with regularity, it is not clear what would qualify as breaking news. Given that we live in an era when constant Twitter updates can affect companies' and municipalities' securities prices, it could be too easy for firms to make a colorable argument, based on any breaking "news source," that a material change to a price has occurred, in which case the firm could avoid its disclosure obligations.

Instead of attempting to determine what standard a firm would need to meet to document and demonstrate that a material change has occurred and define what constitutes a "material change," we urge FINRA to require disclosure in all instances in which there is a material change to the price of a security. If firms wish to provide clarifying information with that disclosure explaining the material change in price, they are free to do so. Our suggested approach would address firms' stated concern that disclosing reference prices during volatile trading days might cause investors to be confused about the prices they see. Our suggested approach would also address another concern that firms have expressed previously, that providing disclosure in some cases but not in others would also lead to investor confusion.

FINRA and MSRB have also proposed to exclude from the proposed disclosure requirements trades that are conducted by a department or desk that is functionally separate from the retail-side desk. FINRA's description of this exemption states that, to qualify for the exemption, the firm must demonstrate through policies and procedures that the firm-side transaction was made by an institutional desk for an institutional customer that is separate from the retail desk and the retail customer. We strongly support this language, as it will help to ensure compliance. However, the policies and procedures language does not appear to be incorporated in the rule language. Considering similar policies and procedures language is incorporated in the rule text relating to firms' establishment of reasonable alternative methodologies, we think it would be helpful to eliminate this ambiguity by adding the policies and procedures language to the rule for the functionally separate desk exemption as well.

MSRB uses the same functionally separate language, but does not define what that means or require firms to demonstrate through policies and procedures that a non-retail desk is indeed functionally separate. We urge MSRB to add policies and procedures language that tracks the language FINRA uses in its description of the exemption. MSRB also has a requirement that the functionally separate principal trading desk through which the dealer purchase or sale was executed had no knowledge of the customer transaction. It's not clear how anyone could ever prove that a

trading desk had no knowledge of the customer transaction, as it would require proving a negative and divining a desk and its traders' states of mind. We urge MSRB to eliminate this requirement. Replacing it with the policies and procedures language will better ensure firms' compliance and regulators' review of firms' compliance.

Conclusion

It is long overdue that firms provide essential cost disclosures to retail investors in fixed income markets. The fact that many firms currently don't provide that information and have so strongly opposed regulatory efforts to require providing it reflects their interest in preserving an opaque market that allows them to extract rents from their less well-informed retail customers.

FINRA's revised approach would fundamentally change this troubling dynamic by requiring firms to provide critical confirmation disclosures to their retail customers. It would result in retail investors' receiving more and better disclosure that would allow them to make better informed investment decisions, and it would foster increased price competition in fixed income markets. In contrast, it is not clear MSRB's revised approach would fundamentally change current market dynamics, as it would allow firms to easily evade their confirmation disclosure requirements. If firms do take advantage of loopholes in the MSRB rule to evade their obligations, retail investors will be no better off than they are currently. We urge MSRB to reconsider its approach and return to a rule that closely tracks FINRA's. And, for all the reasons explained above, under no circumstances should FINRA adopt an approach that tracks MSRB's reproposal.

Respectfully submitted,

Micah Hauptman
Financial Services Counsel

THOMSON REUTERS

Via Electronic Delivery

December 11, 2015

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Alexandria, Virginia 22314

Re: MSRB Regulatory Notice 2015-16: Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers; FINRA Regulatory Notice 15-36: Pricing Disclosure in the Fixed Income Markets

Dear Ms. Asquith and Mr. Smith:

Thomson Reuters appreciates the opportunity to comment on MSRB Regulatory Notice 2015-16 (the "MSRB re-proposal") and FINRA Regulatory Notice 15-36 (the "FINRA re-proposal').[1] Thomson Reuters[2] through our Financial & Risk business unit provides buy-side, sell-side and corporate customers with information, analytics, workflow, transaction and technology solutions and services that enable effective price discovery and support efficiency, liquidity and compliance. In particular, our wealth management offerings[3] include a complete suite of products that enable retail and institutional brokers to manage the daily tasks of their front, middle and back office operations. As a service provider, Thomson Reuters would like to offer an implementation perspective on the re-proposals.

[1] Note the original proposals from the MSRB and FINRA are MSRB Regulatory Notice 2014-20 and FINRA Regulatory Notice 14-52.
[2] Thomson Reuters is the world's leading source of intelligent information for businesses and professionals. Combining industry expertise with innovative technology, it delivers critical information to leading decision makers in the financial and risk, legal, tax and accounting, intellectual property and science and media markets powered by the world's most trusted news organization. For more information about Thomson Reuters, please go to www.thomsonreuters.com.
[3] For more information on Thomson Reuters Wealth Management offerings, see here.

Align MSRB and FINRA Approaches to Mark-Up Confirm Disclosure

The FINRA re-proposal notes that both the MSRB and FINRA have discussed a coordinated approach to confirm disclosure rule-making. We believe it is imperative that the MSRB and FINRA agree on a single set of uniform rules regarding mark-up confirm disclosures. We have seen harmonization between MSRB and FINRA on other initiatives including the no-remuneration indicators set for implementation on May 23, 2016. We see no reason why coordinated rule-making as it relates to mark-up disclosure is not possible.

This approach has a number of benefits including rationalizing implementation effort, reducing investor confusion and rationalizing internal and external training. At many firms, developers and business analysts that program for MSRB reporting changes are the same resources as those responsible for TRACE-related changes. Common definitions and methodologies allow firms to develop a consistent set of modifications with respect to both reporting regimes in a timelier manner. Testing is also simplified if test scripts can be leveraged for both sets of changes. Investor confusion is reduced for those investors that trade both corporate and municipal bonds given that modifications will be consistent across asset classes. Finally, consistency simplifies the training and education that will be required for both internal staff and external clients.

We recommend alignment not only on the definition of the mark-up disclosure but also in the following areas:

- For all confirms, include a link to a search page on the TRACE or EMMA website, as applicable. Retail investors are accustomed to using search engines for financial research. Rather than a security-specific page as proposed by the MSRB, a link to an EMMA or TRACE search page, depending on the security type, which allows a user to input a CUSIP would quickly take retail investors to the data they require without requiring individualized hyperlinks on every confirm. Operationally, this is simpler to maintain for industry participants as well as for FINRA and the MSRB. Deep linking to a specific security increases the likelihood of errors and would require testing of every link to ensure it resolves to the correct webpage. Linking to a search page addresses these issues and is consistent with other retail investor information sites like FINRA's BrokerCheck. Any explanatory text placed on the confirm regarding this link should be concise, taking into account the limited space available on confirms.

- Include time of execution on retail customer confirms based on the time of execution reported to TRACE and EMMA for trade reporting today. This would allow retail investors to more easily identify relevant trade data on the EMMA and TRACE websites.

- Specify dollar amount as the disclosure format. This maintains consistency with equity confirms.

- Eliminate the requirement to "look through" to an affiliate. This is operationally challenging due to information barriers and system limitations. In many cases, affiliates operate as separate broker dealers with policies and procedures prohibiting sharing proprietary data outside of the firm.

Eliminate Look-Forward Component of Re-Proposals

Both the MSRB and FINRA re-proposals would require firms to not only look at preceding transactions within the 2-hour or same day window but also look forward to transactions occurring after a trade is executed in order to determine whether the trade requires a mark-up disclosure. The need to look forward to transactions occurring after the trade will disrupt confirmation processes currently in place. Delays could undermine efforts to maintain operational efficiency and achieve straight through processing. We recommend requiring firms to look back only to preceding transactions that took place in the current business day. By doing this, relevant mark-up prices and disclosure text can be added to the trade ticket and maintain current workflows. Without mark-up information on the trade ticket, we are concerned that an elaborate cancel/re-bill process will be required to accurately reflect the mark-up to be disclosed on confirms.

Exempt DVP/RVP Accounts That May Not Meet Institutional Account Definition

We applaud the MSRB and FINRA for establishing consistent definitions of retail accounts in scope to include those accounts outside of the institutional account definitions established in MSRB Rule G-8(a)(xi) or FINRA Rule 4512(c). However, we are aware that small institutions may not meet those defintions even though they trade via DVP/RVP accounts and rely on institutional confirm processes.[4] DVP/RVP account holders that do not meet the institutional account definitions are typically small investment managers and hedge funds with total assets under $50 million. We respectfully request that MSRB and FINRA exempt DVP/RVP accounts from the scope of this rule. We believe this is consistent with the intent of the re-proposals to focus on the retail segment of the market.

Consider Simplifying Definition of Mark-Up

In order to minimize implementation effort, we recommend simplifying the definition of the term mark-up to mean the differential between the customer price and the price of the inventory account trade. From an implementation perspective, disclosing the inventory account trade price would be the most feasible alternative and provide meaningful insight into broker-dealer compensation. Given that the inventory account trade price is on the trade ticket today, implementation would be limited to establishing mechanisms to add this information to the confirm. This would be a simpler approach as opposed to creating new fields and disclosure text that will be required under either re-proposal. Additionally, it would have no impact on real-time confirmation processing.

[4] Typically, firms use Omgeo's TradeSuite ID confirm process for meeting institutional confirm obligations.

Another benefit of this approach is its consistency with equity preferred confirms which currently provide mark-up disclosures based on inventory account trade price.

If a broader definition of mark-up based on either the FINRA or MSRB re-proposals is required to achieve policy goals, we have identified the following additional issues with both the FINRA reference price and the MSRB prevailing price concepts that we believe must be considered and resolved.

FINRA Reference Price

FINRA's re-proposal has a number of operational challenges based on the complex requirements of the re-proposal including the following:

- The need to address complex scenarios[5] and determine reasonable alternative methodologies. While the FINRA re-proposal offers firms flexibility, the implementation effort required to ensure that permissible methodologies are employed will be a challenge for development and testing.

- The need to evaluate a reference price to determine if a material change in the price of the security warrants excluding the reference price from the confirm or requiring additional disclosures. Firms will need to develop logic to review reference prices for their validity and establish parameters to determine if a material change occured. Guidance would be required to ensure the determination of material change is consistent across the industry.

- The lack of consistency in the determination of the reference price or its inclusion on the confirm will make programming difficult given the number of exceptions and degree of subjectivity involved in making determinations.

- The requirement to add new fields and disclosure text. This is further complicated by the multiple workflows that exist within the fixed income marketplace. Firms use of internal or third party order management systems, trading systems, alternative trading systems (ATSs), back office service providers and confirm vendors will create a number of integration touch points where mark-up data will need to be stored and passed.

MSRB Prevailing Price

While firms are required to determine prevailing market price today, this information is not currently systematized to allow for the population and communication of fields to downstream systems. Similar to the FINRA re-proposal, systematizing this information will mean the creation of new fields and associated integration work.

[5] Complex scenarios include those where there is not a same (or greater) size principal and customer trade or there are one or more intervening principal trades of a different size,

The methodology for determining prevailing market price may differ as described in FINRA Rule 2121 and MSRB G-30 as well as associated Supplementary Materials in both rules. For illiquid securities especially, methodologies other than contemporaneous price will need to be considered, e.g., comparison to similar securities based on yield benchmarking. As noted in FINRA Regulatory Notice 15-46 which provides guidance on best execution obligations for fixed income and other markets: *"FINRA also notes that prices of a fixed income security displayed on an electronic trading platform may not be the presumptive best price of that security for best execution purposes, especially for securities that are illiquid or trade infrequently."* Without an independent source of the prevailing market price, firms will face difficulties in providing this information in a manner that is consistent across the industry. FINRA and the MSRB must address this issue in order for the prevailing market price to be meaningful to investors.

Perform Cost/Benefit Analysis

Given the complexities of the re-proposals outlined above, we recommend performing a detailed cost/benefit analysis of the proposals that are ultimately submitted to the SEC. We note that both the MSRB and FINRA have committed to performing cost/benefit analyses. FINRA indicates that a more fulsome impact analysis is suitable for "significant new rule proposals.[6]" Additionally, the MSRB states that, "The economic analysis drafted for the SEC rule filing should capture the analysis provided in the request for comment but should be more complete as it should also capture relevant information and arguments made during the public comment period and take into account any alterations to the proposed rule made during the rulemaking process.[7]" Firms spend signifcant resources today to maintain and enhance trade reporting. Opportunities to leverage the EMMA and TRACE web portals should be explored as part of this analysis.

As part of the cost/benefit analysis, we believe that policy goals should be clarified in terms of the intent associated with the scope of mark-up disclosures. If expansion of mark-up disclosures to more retail transactions is the ultimate goal, it may be possible to reduce programming costs associated with determining in-scope trades by expanding scope at the outset to eliminate a phased approach to mark-up disclosures. If policy goals will ultimately require an expansion of scope, the costs associated with multiple phases of the project should be evaluated and mitigated. It should be noted that while expanding scope to all retail transactions may address investor confusion and complaints associated with having the mark-up disclosure on only some confirms, determination of the mark-up may be more difficult.

[6] Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking, September 2013

[7] Policy on the Use of Economic Analysis in MSRB Rulemaking at http://www.msrb.org/Rules-and-Interpretations/Economic-Analysis-Policy.aspx

Provide Sufficient Implementation Time

We expect that determination of the reference price or prevailing market price will be performed within OMS/trading systems. However, new fields for the mark-up disclosure and any required disclosure text will need to be passed to back office systems on trade tickets and then on to confirm systems. There are a number of implementation activities that need to be considered across the workflow including precise definition of what price will be disclosed, establishment of new fields to be populated and passed, determination of disclosure text. It will be important for the MSRB and FINRA to work with the industry in establishing a common implementation methodology and industry standards, where possible. We believe that there will be a need for additional implementation guidance from both MSRB and FINRA if rules are ultimately approved.

Once a common approach is proposed by the MSRB and FINRA, we will be better positioned to provide more feedback on implementation issues and timeframe. It is worth noting that recent MSRB trade reporting changes have afforded market participants with twelve month implementation time periods.[8] Changes to confirm processing typically are more complex given the number of integration touch points.

Thank you for the opportunity to comment on the re-proposals. Changes to confirms directly impact our systems and those of our clients; we appreciate the willingness of MSRB and FINRA to consider our comments.

Regards,

Manisha Kimmel
Chief Regulatory Officer, Wealth Management
Thomson Reuters

[8] See MSRB Regulatory Notice 2015-07 published May 26, 2015 announcing a May 23, 2016 implementation date.

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December 11, 2015

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http://www.msrb.org/CommentForm.aspx

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Mr. Ronald W. Smith
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RE: FINRA Regulatory Notice 15-36: Pricing Disclosure in the Fixed Income Markets; MSRB Regulatory Notice 2015-16: Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers

Dear Ms. Asquith & Mr. Smith:

Wells Fargo Advisors, LLC ("WFA") appreciates the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA") Proposed Rule Requiring Confirmation Disclosure of Pricing Information in Corporate and Agency Debt Securities Transactions and the Municipal Securities Rulemaking Board's ("MSRB") Proposed Draft Rule Amendments

to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers (together, the "Proposal" or "Revised Proposal").[1]

WFA is a dually registered broker-dealer and investment advisor that administers approximately $1.4 trillion in client assets. We employ approximately 14,988 full-service financial advisors in branch offices in all 50 states and 3,838 licensed financial specialists in retail bank branches across the country.[2] WFA and its affiliates help millions of customers of varying means and investment needs obtain the advice and guidance they need to achieve financial goals. Furthermore, WFA offers access to a full range of investment products and services that retail investors need to pursue these goals.

I. EXECUTIVE SUMMARY

WFA supports FINRA's and MSRB's objective of improving price transparency in the fixed income markets and applauds the efforts to enhance access to meaningful pricing information for retail investors. As a broker-dealer vested with the responsibility of seeking best execution on transactions for over 7.5 million customer accounts, we support regulatory initiatives to provide clear and useful information to retail investors regarding transactions in the fixed income markets. We also thank both FINRA and MSRB for seeking out and incorporating comments pertaining to their original disclosure proposals. However, the core concerns expressed in WFA's response to FINRA and MSRB's original proposals remain unresolved, particularly our concern regarding the client utility and potential misunderstanding of the disclosure information.[3]

We continue to believe retail investors are best served by continuing to focus on providing meaningful information about prevailing market conditions, ideally via real-time price dissemination tools. Consequently, we believe there should be greater focus on the use of the Trade Reporting and Compliance Engine ("TRACE") and the Electronic Municipal Market Access ("EMMA") price dissemination platforms which provide additional near real-time pre-trade market information to retail investors. We are supportive of including a

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[1] FINRA Regulatory Notice 15-36, Pricing Disclosure in the Fixed Income Markets – FINRA Requests Comment on a Revised Proposal Requiring Confirmation Disclosure of Pricing Information in Corporate and Agency Debt Securities Transactions, October 12, 2015, *available at*: http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-15-36.pdf. MSRB Regulatory Notice 2015-016 - Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers, September 24, 2015, *available at:* http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2015-16.ashx?la=en.

[2] WFA is a non-bank affiliate of Wells Fargo & Company ("Wells Fargo"), a diversified financial services company providing banking, insurance, investments, mortgage, and consumer and commercial finance across the United States of America and internationally. Wells Fargo's retail brokerage affiliates also include Wells Fargo Advisors Financial Network LLC ("WFAFN") and First Clearing LLC, which provides clearing services to 78 correspondent clients, WFA and WFAFN. For the ease of discussion, this letter will use WFA to refer to all of those brokerage operations.

[3] See Correspondence from Robert J. McCarthy to Ronald W. Smith and Marcia E. Asquith, dated January 20, 2014, *available at:* http://www.finra.org/sites/default/files/notice_comment_file_ref/Wells%20Fargo.pdf.

hyperlink to these platforms and enhancing educational efforts for retail investors to better understand the information presented. Moreover, we believe a proposal that mandates the disclosure of the mark-up in riskless principal transactions in conformity with the recommendations set forth in the SEC's 2012 Report on the Municipal Securities Market[4] would provide meaningful information to clients in connection with their transactions. We are concerned that disclosures on other trades will not be subject to uniform processes across the industry and may lead to customer confusion, particularly where market movements or material events (e.g. credit rating change) may occur between the time of the reference trade and the customer transaction. Finally, FINRA and MSRB should align their prescribed approaches so that one method of disclosure results for all fixed income transactions. There is no compelling case for differential regulatory requirements.

II. BACKGROUND

In November 2014, both FINRA and MSRB issued Regulatory Notices[5] (together, the "Initial Proposal") seeking comment on the respective proposals to require firms to disclose additional pricing information for retail-size customer trades in corporate and agency debt securities. Specifically, the Initial Proposal required that, if a firm sells to a customer as principal and on the same day buys the same security as principal from another party, the firm would have to disclose on the customer confirmation (i) the price to the customer; (ii) the price to the firm of the same-day trade (reference price); and (iii) the difference between those two prices.

Over thirty comment letters were received in response to the Initial Proposal. Many of the commenters expressed concern that the specific information proposed to be included on the customer confirmations could be misinterpreted by retail clients. Further, industry members raised significant technical and operational hurdles that would impede member firms from complying fully with the proposal. Finally, commenters advised that the Initial Proposal undermined previous and current efforts to provide greater price transparency through the continued development of TRACE and EMMA price dissemination platforms to provide additional near real-time pre-trade market information to investors.

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[4] Securities and Exchange Commission Report on the Municipal Securities Market (July 31, 2012), *available at*: http://www.sec.gov/news/studies/2012/munireport073112.pdf.

[5] Regulatory Notice 14-52, 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, November 17, 2014, *available at*: http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_14-52.pdf; MSRB Notice 2014-20 - Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations, November 17, 2014, *available at:* http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-20.ashx?n=1.

III. DISCUSSION

WFA supports FINRA's and MSRB's objective of improving price transparency in the fixed income markets and applauds efforts to enhance access to meaningful pricing information for retail investors. Unfortunately, we believe the revised proposals from FINRA and MSRB miss the mark in addressing many of the concerns expressed on the Initial Proposal. We offer the following discussion to highlight the inherent problems with the Revised Proposal and respectfully offer suggestions for a more workable, consistent and meaningful approach.

A. FINRA and MSRB Should Propose a More Coordinated Approach.

Under the Revised Proposal, FINRA and MSRB have offered very different approaches. Each proposal has specified a different time frame under which the required fixed income pricing disclosure is to be computed.

MSRB's revised proposal would require the dealer to disclose the mark-up on retail customer confirmations for principal transactions when they transact on the same side of the market as the customer in the customer's municipal security in one or more transactions that in the aggregate meet or exceed the size of the customer's transaction. Disclosure would be required only where the dealer's same-side of the market transaction occurs *within two hours* preceding or following the customer transaction.

FINRA's revised proposal provides that, for non-complex scenarios (firm principal transaction of the same or greater size without intervening principal trades within the same trading day), the price of the principal trade should be used as the reference price. For complex scenarios (no same or greater size principal and customer trade), firms may employ a reasonable alternative methodology, such as average weighted price of the firm trades that equal or exceed the size of the customer trade, or the price of the last same-day trade executed as principal by the firm prior to the customer trade. The firm must adequately document and consistently apply its chosen methodology.

WFA requests that FINRA and MSRB align their revised proposals. We believe compliance with the two conflicting sets of standards is virtually impossible. Consequently, varying proposals would make it extremely difficult to develop disclosure solutions.

B. The Proposed Confirmation Disclosure Requirements Are Difficult, If Not Impossible, To Effectively Implement.

The process for creating a customer confirmation is currently a complicated activity which relies on inputs from multiple systems to generate a transaction confirmation that complies with existing regulatory requirements. These inputs include, but are not limited to, trade files, security master files and customer files. Additional data points include accrued interest, price and yield information and total funds. The information needed to produce a

confirmation is captured at the time of transaction execution, thus permitting firm systems to efficiently process the necessary information for inclusion on a transaction confirmation.

As outlined in the Revised Proposal, in certain circumstances, firms would be required to gather a portion of the trade data for the customer confirmation hours after the customer trade was executed. Firms would have to undo real-time trade processing, currently used industry-wide, and create a system whereby an alternative methodology may need to be employed to properly calculate the reference price required for the customer confirmation. Specifically, compliance with the Revised Proposals would require technological architecture that does not currently exist in the industry. For example, the additional trade data sought by the Revised Proposal may not currently be retained; thus system enhancements would be necessary to comply with the proposed retention and transmission requirements.

Furthermore, the revised proposed requirements undermine industry efforts to move towards real-time processing as well as making real-time access to trade data available. Today, customers are able to view their trades on-line, should they so choose. Customers have also been encouraged to access EMMA and TRACE to view market and trade data real-time and/or post trade. The proposed requirements seem to deemphasize use of these beneficial industry advances by urging investors to rely on "recreated" data in a paper confirmation to be delivered post-trade, as opposed to more dynamic information in real-time.

C. FINRA and MSRB Should Revive Mark-up Disclosure for Riskless Principal Transactions As A Workable Alterative.

Most importantly, WFA does not believe the confirmation disclosure in the Revised Proposal furthers an understanding by retail investors of prevailing market conditions at the time of transaction execution. Under the Revised Proposal, in many instances a customer may believe the information on the reference trade reflects the prevailing market price at the time of their transaction. However, this may be misleading or inaccurate in instances where there are intervening market movements or significant events. For example, the downgrade in the rating of a particular bond or the occurrence of a catastrophic event may adversely impact the price of a security. This can result in the customer being confused as to whether the difference between the identified price differential is due to mark-up, mark-down or other factors.

WFA also believes that a mark-up disclosure for riskless principal transactions would provide investors with information that is not impeded by various outside market factors and would sustain the current confirmation generation process, as broker-dealers already have the necessary information at the time of trade to initiate the process.

D. FINRA Must Exempt Institutional Customers From the Revised Proposal.

The Revised Proposal states that the customer confirmation disclosure requirements are applicable to non-institutional customers. A non-institutional customer is defined as a

customer account that is not an institutional account. For purposes of clarity, WFA requests that the Revised Proposal be updated to affirmatively exempt both institutional accounts and DVP/RVP institutional accounts[6] from the customer confirmation disclosure requirements of FINRA Rule 2232.

E. The Proposal Undermines Prior/Current Efforts To Provide Greater Price Transparency For Retail Investors (TRACE And EMMA).

For over twenty years, the SEC, FINRA and MSRB have favored development of price dissemination platforms as a more effective alternative to confirmation disclosure. WFA strongly feels that the data currently available, both pre-trade and post-trade, through TRACE and EMMA is far more effective in putting real-time information in the hands of investors than relaying information to customers that may be confusing if not misleading, in a confirmation roughly three days after the trade.

WFA believes the Revised Proposal undermines the use of price dissemination platforms by the introduction of confirmation disclosure that has repeatedly been deemed an inferior alternative. Therefore, investors will be better served by expanding access to price dissemination platforms that provide better insight, in a near real-time manner, into prevailing market conditions.

F. There Should Be Clear Cost/Benefit Analysis Of The Proposed Disclosure Requirements and Substantial Time To Allow For Implementation.

Neither FINRA nor MSRB have provided any statistical information or studies which indicate that retail investors lack sufficient information or are unable to obtain relevant pricing information prior to or after trading in fixed income products. WFA requests that prior to issuing such potentially burdensome regulations on the industry, both FINRA and MSRB undertake objective studies which illustrate that disclosure on a customer confirmation is preferential to the near real-time price dissemination currently available to retail customers. Further, due to the substantial systemic requirements within the Revised Proposal, WFA also requests a minimum three year implementation period.

IV. CONCLUSION

WFA believes investors are best served by the industry continuing to focus on providing meaningful information about contemporaneous market conditions via more advanced near real-time price dissemination tools. Consequently, WFA respectfully recommends the Proposal be withdrawn or in the alternative, significantly altered as described above.

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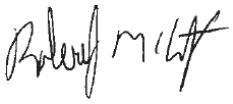
[6] Delivery Versus Payment (DVP) and Receive Versus Payment (RVP) accounts do not meet the "institutional account" definition, but rely on the institutional confirmation process.

WFA appreciates the opportunity to respond to FINRA and MSRB's Proposal. Although WFA believes the Proposal as currently structured should be withdrawn, we remain willing to assist FINRA and MSRB in achieving greater price transparency for retail investors. WFA welcomes additional opportunities to respond as this Revised Proposal evolves. If you would like to further discuss this issue, please contact me at (314) 242-3193 or robert.j.mccarthy@wellsfargoadvisors.com.

Sincerely,



Robert J. McCarthy
Director of Regulatory Policy

Ms. Asquith:

Thank you for the opportunity to comment on proposed required confirmation disclosures contained in Notice 15-36. The new proposal is a substantial improvement over that originally published in Notice 14-52. The removal of the size requirement, exempting most new issues and requiring a TRACE link all improved the functionality of the proposal. However, in order to limit a potential unintended consequence of the proposal, FINRA should adopt the MSRB time threshold of two hours.

The proposed required confirmation disclosures are part of a concerted effort on the part of regulators to improve the market efficiency obtained by retail investors. It is believed that by requiring a dealer to disclose "mark-up" or whatever one chooses to call the profit the dealer makes on the transaction and by referencing the source of available pricing data, a retail purchaser will be more likely to act rationally and choose to trade with dealers who work for less spread. (Disregard for the moment the reality that many clients by bonds on yield, not price.) The problem is that many retail clients trade with only one broker and will follow the instructions of that broker, particularly when it comes to fixed income product. These clients are also the ones most likely to disregard the "mark-up" information. Furthermore, there will be broker dealers that simply refuse to sell fixed income inventory to retail clients until the required mark-up disclosure period has ended, thus preventing retail access to the most advantageously priced offerings. This is most likely to occur in very large firms with complex business models and where retail clients are less likely to analyze competing bond offerings. Consequently, it would be most advantageous to retail investors if the disclosure period were shortened, otherwise almost every offering many clients see will be stale. Additionally, this would reduce the anti-competitive aspect of the proposal.

Ideally, it would be understood that clients buy bonds based upon yield and the profit earned by the dealer should be irrelevant. Unfortunately, many bond investors are not selecting bonds based upon an analysis of what is available in the market and it is understandable that regulators would want to provide these investors with additional protection. FINRA will best accomplish its goal by adopting the two hour period chosen by the MSRB.

Thank you again for the opportunity to comment.

Chris Melton
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Coastal Securities

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December 11, 2015

Submitted Electronically

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Financial Industry Regulatory Authority
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Municipal Securities Rulemaking Board
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RE: **FINRA Regulatory Notice 15-36: FINRA Requests Comment on a Revised Proposed Rule Requiring Confirmation Disclosure of Pricing Information in Corporate and Agency Debt Securities Transactions**

MSRB Regulatory Notice 2015-16: Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers

Dear Ms. Asquith and Mr. Smith:

On behalf of the Bond Dealers of America ("BDA"), I am pleased to submit this letter in response to Financial Industry Regulatory Authority ("FINRA") Regulatory Notice 15-36 and Municipal Securities Rulemaking Board Regulatory Notice 2015-16 (the "Notices"), requesting comment on proposed rules to require the disclosure of market or pricing reference information on retail-trade confirmations for municipal, corporate, and Agency fixed-income securities. BDA is the only DC based group representing middle-market securities dealers and banks focused on the United States fixed-income markets and we welcome this opportunity to present our comments on the Notices.

BDA believes that increasing transparency by providing an additional pricing disclosure to retail investors could be beneficial to the marketplace if it can be done at reasonable cost to dealers by utilizing and leveraging the transaction information that regulators are required to receive after each transaction. Additionally, to be valuable, the rule must be understood by retail investors. BDA strongly urges regulators to pursue a harmonized rule that represents the least cost, least complex, and most understandable disclosure method. BDA believes neither the MSRB nor FINRA have put forth a proposed rule that fulfills those criteria or enables retail investors to compare their trading costs to other retail investors in the market. Also, BDA does not believe that estimating the regulatory cost impact of this rule is even possible at this point.

BDA's Markup Disclosure Recommendations

- Methodology: BDA recommends that FINRA and MSRB work with dealers to develop a lower-cost solution that leverages the transaction data that is centrally reported to TRACE and EMMA. This would allow for retail confirmations to include a price comparison to the average inter-dealer daily trade price.

- Scope: The disclosure should be required for retail trades where the dealer has entered into a same-day principal transaction on the same side as the retail investor and the quantity of the dealer principal trade is the same size or greater than the retail trade.

- Timeframe: The disclosure should be based on the full trading day basis outlined in FINRA's notice in order to minimize technology costs and operational complexity associated with a shorter time period.

- Disclosure Format: The disclosure should be displayed in dollar terms or as a percentage of the markup relative to the inter-dealer price.

- Harmonize: BDA strongly urges regulators to publish a fully harmonized rule. BDA members have spent an enormous amount of time and resources reacting to and researching solutions to the 2014 proposed rules and the current proposals.

- Reduce Complexity: Broker-dealers urge regulators, as part of a coordinated rulemaking process, to focus on proposing the least complex, least-cost methodology that best achieves the stated goals of the regulation.

BDA still believes these rules are based on a fundamental misconception of market risk. Dealers have multiple bond positions in inventory. Some bonds are held for a day or less and others are held for several days or weeks because investor demand does not materialize to the extent that the dealer expected due to basic market dynamics. Unless there is an existing contra side order, a dealer is at risk when it purchases a security. Therefore, BDA would prefer that regulators publish a truly "riskless principal" rule for fixed income, similar to SEC Rule 10b-b, that applies to equity transactions, where dealer cost basis is disclosed and the trade is truly "riskless."

BDA appreciates the improvements that regulators have made to the proposals.

BDA appreciates the improvements that regulators have made to the confirmation disclosure proposals compared to the 2014 proposals.

Retail Focus

The Notices are now explicitly focused on retail customers. This was a significant concern for BDA members that routinely transact with institutional customers in trade sizes that would have been considered 'retail size' by the previously proposed rules. A retail-account-focused rule proposal is superior. Although, there are some concerns with the potential application of this rule to smaller institutions that are below the quantitative thresholds.

Secondary Market Trades

Additionally, BDA believes that the Notices are improved by the exclusion on new issue transactions at the "list-offering price" from the scope of the rule proposals. As MSRB's Notice notes, in these instances, the offering documents contain ample information, including the public offering price and underwriter compensation.

Link to Trading Data Pages

BDA believes leveraging the data reported to TRACE and EMMA and increasing awareness of the comprehensive pricing information available on these sites is important. The proposals do seem to differ on where on the website the investor would be directed to. BDA believes a general link to the main page of EMMA and TRACE would be operationally easier to achieve than directing investors to a security specific page.

BDA believes the proposals are too complex.

Specifically, the Notices outline two different methodologies for computing the retail confirmation disclosure and for the format of the disclosure. The MSRB proposes to require a retail confirmation disclosure of a markup relative to the prevailing inter-dealer price at the time of the retail trade. Alternatively, FINRA has proposed a requirement for a confirmation disclosure based on the differential between a retail transaction price and a dealer's same day principal trade in the same security. BDA observes some unique challenges with each of the complex proposed methodologies.

FINRA's complex methodology would require dealers, of all sizes, to implement a technologically intensive and expensive solution that would require significant new operational and trading systems to be put in place, including working with third-party service providers and vendors to create new and expensive solutions to accurately capture two associated trades executed on the same day and then transfer the differential onto a customer confirm. The complexity with MSRB's alternative proposal is based on the possible ambiguity of identifying contemporaneous cost with enough certainty to put the

information on a customer confirmation. The common problem with the proposals is that they require dealers to create new systems, processes, and procedures to capture transaction data that is held already held and publicly disseminated by regulatory agencies.

In light of the unprecedented volume of new regulations impacting dealers in recent years, BDA believes that an overly complex, technologically intensive regulation must be avoided. Broker-dealers are required under FINRA and MSRB rules to abide by the highest standards of commercial honor. FINRA Rule 5310 and MSRB Rule G-18 require dealers to execute customer trades at prices that are "as favorable as possible under prevailing market conditions." In addition, transactions must be executed for fair prices and commissions under FINRA Rule 2121 and MSRB Rule G-30.

In the past decade, mark ups in the fixed-income markets have been consistently narrowing. As FINRA notes in its proposal, the median mark up for a "retail-size" investment grade corporate bond transaction is 51 basis points. In 2012, the Securities and Exchange Commission's reported that the average corporate bond mark up in 1999-2000 was 124 basis points. By contrast, according to the Investment Company Institute, the average annual bond fund expense fee was 70 basis points and the average front-load was 70 basis points in 2014.[1]

The premise of this regulation is to ensure that, despite all of the existing rules and the associated enforcement of those rules all of which ensure quality execution and the public reporting of every trade to EMMA and TRACE that retail investors could derive additional benefits if they better understood dealer transaction-based compensation. BDA does not disagree with that notion, but BDA does disagree with the solution that regulators have proposed because it requires dealers to devote massive amounts of resources to comply when a simpler, less costly alternative exists.

BDA believes the FINRA proposal is too complex and will be too costly.

FINRA's reference price approach is problematic primarily because it is too complex and will be too costly from a technology, compliance, and operational standpoint. As BDA discussed in its 2014 comment letter, redesigning dealer systems to capture a reference price is operationally intensive and will require a full system re-build for many dealers. This will be a significant cost burden, especially for smaller dealers that have fewer compliance personnel and less revenue to divert from core operations to fund growing technology and compliance budgets.

The reference price solution is more complex and this fact reduces the value of the disclosure to retail investors. The proposed "alternative methodology" for complex trades is a particular element that BDA views as far too complex. Retail investors may not understand the reference price disclosure in its simplest form. BDA believes that the disclosure will be significantly less well understood if differing methodologies are allowed for "complex" trades. These types of exceptions, including the exception for

[1] Investment Company Institute Fact Book 2014: http://www.icifactbook.org/fb_ch5.html#fees

'material change provision', will conceivably allow for different retail confirmation disclosures for the same exact trades depending on the judgment and chosen procedure of different dealers all executing different, but similar, trades and what principal transactions that dealer has entered into during the trading day. This design means that retail investors across the marketplace will receive inconsistently computed confirmations, thus reducing the value, clarity, and comparability of the disclosure to transactions in the marketplace generally.

Furthermore, BDA does not believe that a reference price disclosure will give retail investors a valuable indicator with which they will be able to understand transaction costs and dealer compensation in the market. Dealers enter into principal trades at various prices and quantities throughout the trading day. Therefore, the reference is not going to consistently be a valuable indicator for transaction costs in comparison to other investors in the marketplace transacting at the same time in the same security. In fact, it will be a confusing indicator because, unlike the inter-dealer prevailing price, it is a reference to where the market was and not what the current market price is or what the inter-dealer price is at the time of the retail investor trade.

For example, as BDA stated in its previous comment letter, a dealer may purchase bonds at 99 in a principal capacity and then enter into a sale, possibly hours after the initial transaction, at a 102 in full compliance with the dealer's best execution responsibilities. At that point, another dealer could be executing comparable retail sales at 102.5 or 103 with a cost-basis (for disclosure purposes) of 101. BDA notes that the disclosure—by definition—is based on where the market was rather than on the actual market conditions at the time of the executed trade. This creates the opportunity for a highly misleading disclosure. In this instance, the dealer that filled the customer order at the superior market price will be required to disclose a larger markup than the dealer that filled the customer order at the inferior price. The potential impact on the market, especially the impact on liquidity, that could be caused by providing this misleading information to investors is currently unknown and should be studied fully for the benefit of investors and the marketplace.

The premise for the proposed regulation is to allow retail investors to have greater information about transaction costs and to allow retail investors to approach their broker informed with greater information about their transaction costs. BDA does not believe the dealer-reference price approach is the optimal method for providing the information to retail customers to inform that discussion.

BDA believes the MSRB's methodology introduces significant new risks due to its ambiguity.

Of the proposed disclosure methodologies, BDA believes the central element of MSRB's methodology, which proposes a mark up disclosure relative to the prevailing inter-dealer price at the time of the retail trade, is a step in the right direction because it attempts to limit technology and operational costs. The inter-dealer price would be used

to compute the required markup disclosure, in dollar terms and as a percentage, which would be displayed on retail confirmations.

BDA believes that the biggest uncertainty created by the MSRB's methodology would be with reliably and consistently ascertaining inter-dealer cost for computing and reporting the confirmation disclosure. MSRB's proposal contemplates a marketplace where inter-dealer price is readily observable and universally agreed upon. However, in certain instances, there may be a tightly distributed range of views amongst dealers for what inter-dealer cost is at a given point in time. This introduces the risk that an examiner could disagree with one trader's specific determination of the prevailing inter-dealer market price, which could lead to violations of MSRB and FINRA rules regarding accuracy of customer confirmations. This is a very serious concern with the MSRB approach.

BDA believes these risks could potentially be reduced, to a certain extent, through guidance. Specifically, dealers would benefit from guidance outlining what due diligence process and procedures would be required related to the documentation of the inter-dealer cost and how would those procedures fit within the existing due diligence and documentation requirements related to the best execution rules. Best execution rules allow for a range of acceptable trade prices to be considered if a thorough process for ascertaining market price is employed. BDA is concerned that differing views about prevailing market prices could give rise to serious and unnecessary violations of rules related to confirmation accuracy. Therefore, it would be useful to provide guidance that describes hypothetical transactions, in addition to what types of processes and documentation would be required.

If the premise of these rules is to foster greater understanding of dealer compensation and allow retail customers to understand execution quality versus other retail customers, the MSRB proposal may allow for that to take place with less complexity, and in a less costly way, than the FINRA proposal. BDA believes that the MSRB methodology would provide a more consistent and meaningful disclosure because retail investors would have the same reference element, the prevailing market price, and the disclosure would be more consistent for similar retail transactions executed at roughly the same time.

BDA strongly urges regulators to harmonize their rules.

Currently, the Notices outline two vastly different proposed rules. The worst possible outcome for dealers, especially smaller dealers, is two distinctly different final rules. Two different rules would mean a doubling of implementation and technology-cost burdens and would create a massive and unnecessary compliance burden for dealers on an ongoing basis. BDA understands that it is the intent of regulators to harmonize the proposals to the greatest degree possible. However, BDA wants to stress that a harmonized rule is absolutely essential, especially for smaller dealers who are already struggling with vastly higher compliance and technology costs as a result of new regulations.

FINRA's proposal notes that 70% of transactions in corporate credit are concentrated amongst 20 dealers. In light of the ongoing trend towards greater dealer consolidation, doubling the regulatory cost impact on dealers, especially smaller dealers, would likely accelerate the consolidation trend. Supporting greater consolidation of trading amongst the largest dealers at the expense of smaller dealers would be a perverse outcome for a rulemaking designed to allow retail investors to benefit from increased competition amongst dealers.

In addition to harmonization, BDA urges regulators to recognize that this is a significant rulemaking that will have a large impact on how dealers operate, from a trading, operations, and technology standpoint. Each time a proposal is put forth, dealers are required to assess the proposal as if it were a final rule. Dealers have to interact with operational, compliance, legal, trading, internal technology staff, and third-party vendors to assess the extent and cost of the potential systems upgrades, including the development costs of third-party vendor solutions. This is expensive and time consuming for firms with limited resources and limited staff. It is important for regulators to engage dealers and enter into robust discussions about the systems and technology impact and costs associated with this proposal in order for regulators to begin to understand the complexity and costs associated with the proposals. BDA previously recommended a feasibility study so that regulators could fully contemplate the costs associated with this proposal. BDA is disappointed that that study did not take place prior to these new proposals being published for comment.

BDA urges regulators to pursue the least complex, least-cost method by leveraging TRACE and EMMA data.

If regulators are determined to require a confirmation disclosure on a population of trades that is larger than purely "riskless principal" transactions, BDA recommends regulators develop a harmonized proposal based on the least complex, lowest cost proposal by using the centralized data that is already reported to TRACE and EMMA.

BDA recommends that regulators leverage the transaction data that they already hold to provide the type of retail confirmation disclosure the proposals are designed to create. Both the MSRB and FINRA have all the transaction data supplied to them throughout the trading day and are engaged in constant public price dissemination throughout the trading day. At a much lower cost to broker-dealers, and with much greater clarity, than the systems outlined in the Notices, FINRA and MSRB could compute the daily average inter-dealer price and require customer confirmations to include the differential (in dollar terms and as a mark up percentage) between the daily average inter-dealer cost price and the retail investor's transaction price. This would allow customers to better understand dealer compensation and would provide sufficient information for a customer to contact their dealer to discuss the execution of their trades.

Additionally, BDA would also like to note that, especially in the municipal securities market, the difference between a retail customer's cost and the inter-dealer

contemporaneous cost, the dealer's reference price, and the average daily inter-dealer cost would, in most cases, be minimal.

This method represents a more efficient way of delivering a confirmation disclosure. BDA is ready to work with regulators to improve the proposals and to discuss alternatives that would be less costly and deliver pricing information that would allow retail investors to be more informed about the marketplace.

Thank you again for the opportunity to submit these comments.

Sincerely,

Michael Nicholas
Chief Executive Officer

December 11, 2015

BY ELECTRONIC MAIL

Marcia E. Asquith
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Financial Industry Regulatory Authority
Board
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Ronald W. Smith
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Municipal Securities Rulemaking

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Re: FINRA Regulatory Notice 15-36
Pricing Disclosure in the Fixed Income Markets

MSRB Regulatory Notice 2015-16
Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers

Dear Ms. Asquith and Mr. Smith:

RW Smith & Associates, LLC strongly supports transparency efforts within the bond markets. In regard to these proposed rules, however, we continue to be concerned that they will not provide retail customers, the intended beneficiaries of transparency, with clear or useful information. To the contrary, especially with the FINRA proposal, we believe the rule as proposed would lead to widespread confusion, specifically within the retail market.

As we have stated in meetings time and again with both regulatory agencies, we remain extremely concerned that two peer organizations, FINRA and the MSRB, that have consistently expressed a desire to align their rule-making continue to issue such disparate proposals. The actions of both organizations have led members to reasonably conclude that neither regulator, nor their boards, is willing to concede their position on their proposal. This continues to trouble members because in the end neither FINRA nor the MSRB has the ability to force the other to capitulate, and the result from a regulatory stalemate between intractable counterparties would be operationally and financially disastrous for member firms.

RW Smith, along with every other member firm we spoke to in regard to these proposals, would like to once again encourage both FINRA and the MSRB to reconsider their proposals, and as a reasonable alternative turn their attention back to TRACE and EMMA. The industry has funded the creation and maintenance of both of these technology platforms to the tune of over $130 million and it is our position that the focus of both the regulators and the industry should now be on increasing visibility, familiarity and usage of the investor tools and market data available on TRACE and EMMA. There are a multitude of approaches to achieve the objective, such as implementing hyperlinks on electronic confirmations, and member firms are ready and willing to work with the regulators to move this approach forward.

We understand from some of the FINRA board members that there is a firmly-held belief that retail customers will benefit from the production of a “reference price” provided on their trade confirmations. While we applaud and are in alignment with the intention of the board, we would

strongly encourage them to listen to members and member firms who have been in the retail market for decades, and speak from vast and deep experience. It is widely held by market participants that the construct of a reference price that can and will change from one firm and one confirmation to another on the same CUSIP number will without a doubt be confusing and, in the end, meaningless to retail customers. If so many of us who are in the business hold this as an absolute, why does our well-informed and well-intentioned feedback continue to fall on deaf ears at FINRA? As an alternative, we would suggest providing retail customers with a link to EMMA and/or TRACE so they could view date-specific or current market pricing. If the objective is to get market pricing information into retail customer hands, then let's do exactly that by connecting them into the very robust platforms of EMMA and TRACE. A "reference price" is meaningless to retail and we strongly oppose the adoption of any version of this proposal.

If, in the end, some version of either of these proposals move forward, it is imperative that both FINRA and the MSRB adopt a uniform rule. In no scenario should two differing rules be passed and implemented. Working in concert, determine the objective: is it transparency of pricing or markup disclosure or both? If it is transparency of pricing then move forward with a proposal regarding links to EMMA and/or TRACE, and if it is markup disclosure then go with riskless principal transactions only. The SEC has long held that "riskless principal" transactions are the economic equivalent of "as agent" transactions and, as we all know, member firms are required to disclose transactional commissions on customer confirmations of As Agent trades. We suggest that FINRA and the MSRB use the same approach to riskless principal transactions; there is no need to reinvent the wheel, just use the agency methodology as your baseline.

A brief comment on the subject of "gaming the system", FINRA has expressed a concern that the 2-hour window proposed by the MSRB would allow an opportunity for members/member firms to game the system in order to avoid complying with the disclosure rule. The statistics clearly show that the vast majority of riskless principal transactions occur within 15-minutes of one another, the regulators have access to firm and transaction-specific data, and the examination process inclusive of this data would clearly show if any "gaming" was taking place once the disclosure rule was implemented. Moreover, we would like to underscore with both regulators that the overwhelming majority of industry members are rule-abiding, honest, hard working individuals - and firms. Do not write rules for the half-percent that end up costing the rest of us millions of dollars to implement, write them for customer and market protection and the 99.50% of the rest of us, and then utilize Member and Market Reg in ferreting out the bad actors.

In closing, RW Smith continues to believe there are better, more efficient, and more effective ways of achieving the twin objectives of pricing disclosure and riskless principal markup disclosure for retail customers. We have included our suggestions in this comment letter and would like to encourage both regulators to continue to engage the industry on the best and most reasonable way to achieve these objectives.

Finally, we would like to note that RW Smith participated in the drafting of the SIFMA comment letter, and would like to officially represent our support of that submission.

Thank you for your consideration of our comments.

Sincerely,

Paige W. Pierce
President & CEO
RW Smith & Associates, LLC

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11 December 2015

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

Re: Pricing Disclosure in the Fixed Income Markets (Regulatory Notice 15-36)

Dear Ms. Asquith:

CFA Institute[1] is pleased to comment on FINRA's proposed rules requiring its member firms to disclose certain information on customer confirmations for transactions in debt securities. CFA Institute represents the views of those investment professionals who are its members before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues that affect the efficiency, integrity and accountability of global financial markets.

Executive Summary

Need for both pre- and post-trade transparency. CFA Institute strongly supports efforts to increase transparency in the fixed-income market, and believes that measures to provide additional pre-trade information are warranted, in addition to the post-trade transparency that this proposal seeks. We encourage FINRA to consider additional ways to increase this transparency, including providing *all* customers with links to Trade Reporting and Compliance Engine (TRACE) data, not just select customers, as proposed.

Required disclosure in complex trades. We recommend use of a uniform standard for determining the reference price to be disclosed, even in complex trades.

Disclosure when there are material changes to the price of a security. We do not agree with the proposal that would allow dealers the option to omit disclosure of the reference price in cases

[1] CFA Institute is a global, not-for-profit professional association of more than 133,700 investment analysts, advisers, portfolio managers, and other investment professionals in 145 countries, of whom more than 127,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 147 member societies in 73 countries and territories.

where a material event results in significant price swings. Instead, we believe a better option is to require dealers to provide that disclosure with clarifying language.

Discussion

We agree with FINRA's concern that "investors in fixed-income securities currently are limited in their ability to understand and compare transaction costs associated with their purchase and sales." This is particularly noteworthy, given FINRA's own research indicating that "some customers paid considerably more than others in similar trades." We thus strongly support FINRA's efforts through this proposal to shine more light into the fixed-income market and to provide customers with additional information about their specific transactions.

Price Disclosure for Similar Transactions

As proposed, all member firms acting in the capacity of principals in transactions involving corporate or agency debt securities would have to disclose on retail customer confirmations:

- The price the customer paid for the bond;
- The "reference price" of the security subject to the principal trading transaction;
- The differential between the price the customer paid and the reference price; and
- A reference — and hyperlink if the confirmation is electronic — to publicly available TRACE data.

This would be required when firms are acting as principal and sell to, and buy from, their customers the same securities during that same trading day. Transactions not involving firms trading as principal would not trigger any requirement to provide this link.

Difference and Similarities to Municipal Securities Rulemaking Board Proposal

FINRA notes that it has discussed with the Municipal Securities Rulemaking Board (MSRB) a coordinated approach to rulemaking in this area. Similar to the MSRB, FINRA hopes through this rulemaking to provide investors with information that will help them better evaluate the costs and services received from their firms relating to select transactions. By providing links to the TRACE data, FINRA also hopes customers will gain understanding about firms' pricing practices.

The two proposals differ, however, in several respects, and FINRA invites comment on the differences. To that end, we provide suggestions where we favor the MSRB approach or otherwise believe uniformity is in the interests of investors.

Criteria for Triggering Disclosure

In an earlier proposal, FINRA proposed using a "qualifying size" trigger for additional disclosure requirements. We support FINRA's decision in this revised proposal to instead use a "retail customer account standard." This approach is not only a clearer and more direct standard for firms to apply, but also is consistent with the approach proposed by the MSRB.

Alternative Methodologies for More Complex Trades

Under the proposal, firms would need to determine and disclose the "reference price" of the security subject to the principal trading transaction. FINRA has proposed two approaches for making this calculation. In a straightforward scenario where the retail and firm principal transactions do not have intervening principal trades during the same trading day, and the principal trade is the same size or greater than the retail trades, the reference price would be the price of the principal trade.

Where there are intervening trades of differing prices or the principal trade is not equal to, or greater than, that of the retail customer, FINRA proposes giving firms flexibility to determine the reference price. The proposal notes that in these cases, firms can employ a "reasonable alternative methodology," including the average weighted price of firm trades that were equal to or more than their customers' trades. They also could use prices for the last same-day trades the firm executed as principal to their customers' trades. In all cases, firms would have to consistently apply whatever methodology chosen.

We agree with FINRA's assessment that while this flexibility may be more cost-effective for firms, it also would reduce comparability and thus investors' ability to evaluate transactions. We thus argue for adoption of one uniform standard to be applied in all scenarios. We also recommend that should FINRA elect to retain use of a reference price, that it consider requiring firms to disclose the percentage of the price differential. This, we believe, would provide customers with a better contextual basis for comparison.

Material Changes to the Price of the Security

In cases where a material event (such as credit downgrades or breaking news) affects market prices and results in significant swings in bond market prices between the times of customer and firm trades, firms would have flexibility whether or not to disclose the reference price. They could choose not to disclose or disclose with clarifying information. In providing firms this

option, FINRA reasons that depending on the circumstances, investors could be confused about the differences in the prices resulting from the abnormal swings.[2]

We encourage eliminating the option of whether to provide the price in these circumstance. While we appreciate FINRA's concern for investor confusion that might stem from large market swings, we believe investors should be able to rely on receiving a reference price. To that end, we recommend that firms be required to provide that reference price with clarifying information.

Link to TRACE Data

Under the proposal, only customers who are receiving additional disclosure due to firm principal trades in the same security would receive a link from their firms to TRACE on their confirmations. While we agree this will help direct those affected to a source with more information, we believe more should be done to increase transparency in fixed-income markets.

We favor the approach taken in the MSRB proposal. Under that proposal, firms would provide links to the Board's EMMA reporting system for all retail customer confirmations, regardless of whether the transactions involve trading as principal. All retail customers deserve to receive direct links to sources where they can gain additional information about their investments and price differentials, and better educate themselves about this market, generally. To that end, we recommend that firms provide all customers with links to TRACE.

Fixed Price New Issues

We support FINRA's proposal to exempt from the proposed disclosure requirements those transactions that are sold on their first trading day at the fixed offering price, on the basis that sufficient information accompanies new issues. We agree that disclosure requirements should continue to apply to variable price offerings that are part of secondary trades.

Trades Occurring on Functionally Separate Desks

Similar to the approach proposed by the MSRB, FINRA is proposing that transactions occurring on "functionally separate" trading desks located within a firm be excluded from calculating a reference price for purposes of disclosures on customer confirmations. Specifically, firm-side transactions that are functionally separate from those conducted on the retail-desk side would be exempt from disclosure, provided that firms have policies and procedures in place that demonstrate to examiners the transactions for institutional customers are separate from the retail

[2] The proposal makes clear that swings in prices resulting from general market volatility or normal price fluctuations would not be a basis for allowing firms the option of whether or not to disclose the reference price.

desks and from retail customers. We believe this approach reasonably achieves the goal to provide investor protections while also recognizing the practical realities of firm operations.

Positions Acquired by an Affiliate on a Previous Trading Day

FINRA's proposed disclosure requirements apply to relevant transactions occurring within the same trading day. Thus, the proposal would not apply when firms acting as principals execute trades with their affiliates whose position satisfies the trade, but the trade was not acquired on the same trading day. While we agree that this approach is reasonable when focusing on the same trading day as the pivotal time-frame for triggering disclosure requirements, we favor the alternative "look-through" approach proposed by the MSRB, and suggest adoption of this approach for consistency.

Conclusion

We strongly FINRA's efforts to increase the transparency in the fixed-income market by providing customers with new disclosures relating to their trades, and about the market We encourage FINRA and the MSRB to work together to better coordinate their approaches where the end goals are the same. This will increase consistency while also reducing investor confusion. Should you have any questions about our position, please do not hesitate to contact Kurt N. Schacht, CFA at kurt.schacht@cfainstitute.org, 212.756.7728 or Linda Rittenhouse at linda.rittenhouse@cfainstitute.org, 434.951.5333.

Sincerely,

/s/ Kurt N. Schacht

Kurt N. Schacht, CFA
Managing Director, Standards and
Financial Market Integrity
CFA Institute

/s/ Linda L. Rittenhouse

Linda L. Rittenhouse
Director, Capital Markets Policy
CFA Institute

December 11, 2015

Electronic Mail

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

Request for Comment on Pricing Disclosure in the Fixed Income Markets 15-36

Dear Ms. Asquith:

TMC Bonds, L.L.C. ("TMC") welcomes the opportunity to respond to FINRA's Request for Comment #15-36. For efficiency, we have filed this response with the MSRB as well, as TMC seeks similar guidance in both markets.

TMC is an electronic exchange for trading fixed income securities and a registered Alternative Trading System ("ATS") with the Securities and Exchange Commission. Started in May 2000, TMC has become a leader in facilitating electronic trading for both taxable and tax-exempts bonds over its open and anonymous platform. As counter-party to each side of a trade, TMC reports approximately 4,500 municipal trades daily to

the MSRB as riskless principal. TMC also has a significant and growing presence in the taxable market. In October, TMC accounted for approximately 16% of the corporate transaction volume for transactions with trade size under 250 bonds. As with municipals, TMC is the counter-party to the trade and reports its riskless principal trades to TRACE.

While the MSRB has filed a similar request for comment in Regulatory Notice 2015-16, we would like to emphasize support for FINRA and the MSRB to have a fully harmonized ruling. The cost of compliance for one proposal is already significant, and the possibility of adding multiple scenarios for different products greatly increases the programming complexity and cost. While there are differences in form for each market, we believe that the base methodology from either proposal does not present any issues that would negate uniform reporting.

Technology challenges aside, we are greatly concerned that the current Draft Rule has inconsistent goals and deviates from the Securities and Exchange Commission's 2012 Report recommendation to "consider requiring municipal bond dealers to disclose to customers, on confirmations for riskless principal transactions, the amount of any markup or markdown" by virtue of using an arbitrary time parameter as a means to identify riskless trades. While we believe the MSRB's shorter time frame is more meaningful than FINRA's "same-day" requirement to capture an estimated mark-up, its weakness is that it does not truly capture the spirit of disclosing "riskless-principal" mark-ups but instead discloses all matched trades executed within the set time. A time-based methodology, unless measured in much smaller increments, is including the baby with the bath water, as the true at-risk trades will be included with the riskless trades. This conflation of mixing the accurate with the misleading becomes more problematic as the time parameter is widened, as suggested in the FINRA proposal. Any trade committed without an order in-hand is an "at-risk" trade.

The time parameter obfuscates the potential risk that a trader takes and prices into a trading decision and blurs its meaning when a positioned bond is moved quickly out of inventory.

The time dilemma highlights the difficulty of trying to capture an idea that is difficult to define. If one is truly interested in disclosing any principal trade mark-up, then the only meaningful calculation is from the prevailing market price. As in most instances for illiquid bonds (using TMC's municipal experience as a barometer), 85% of the transacted bonds have no market depth, meaning it would be the owner of the security estimating the prevailing market price. Likewise, for disclosing any riskless principal trade mark-up, then the dealers contemporaneous cost would be appropriate.

Therefore, we believe that the only appropriate mark-up available for disclosure would be for true riskless principal trades, in which a matched trade is executed contemporaneously. We would support the regulators explicitly defining a riskless-trade and modeling language similar to FINRA's NTM-99-65 for equities, which defines a riskless-principal transaction as "a transaction in which a member, after having received an order to buy (sell) a security, purchases (sells) the security as principal and satisfies the original order by selling (buying) as principal at the same price (the offsetting "riskless" leg). Generally, a riskless principal transaction involves two orders, the execution of one being dependent upon the receipt or execution of the other; hence, there is no "risk" in the interdependent transactions when completed." We would also seek further transparency on current market data where a shorter time window can be used than the "same-day" recommendation. How does this change for a 2 second window? In a study conducted by Larry Harris, Chair in Finance USC Marshall School of Business, entitled "Transaction Costs, Trade Throughs, and Riskless Principal Trading in Corporate Bond Markets", corporate bond trades that occurred with a matched side within 2 seconds represented 41.7%

of all trades. As corporates can be sold short, this number suggest that for municipals a matched trade number should be higher, and therefore the suggested MSRB 2 hour time window may be an effort to prevent firms from engaging in manipulative behavior as opposed to truly identifying matched trades. Thus, we would support defining a riskless transaction for purposes of mark-up disclosure and adding language similar to the MSRB's Rule G-14 that prohibits positioning bonds in a fictitious manner or in furtherance of any fraudulent, deceptive or manipulative purpose.

We further support this methodology as, under the current proposal, the integration of systems to calculate the reference price will be expensive and, for some firms, nearly impossible to effect with current infrastructure. For example, TMC has clients who use a principal trading account to facilitate buying and selling bonds. There is no cost system for tracking P&L on the individual trades with this type of account; only the remaining cash balance in the account defines the theoretical P&L for the day. While the MSRB stated that most firms already know their cost due to regulatory requirements, many firms use a defined matrix that determines the mark-up to insure that the advisor works for a reasonable profit and thus track the mark-up, not the cost. This proposal would require these types of firm to build out a new system to track costs on an individual trade basis. Furthermore, in an environment that is encouraging firms to report, settle, and transact at faster times, the extra point of friction to calculate a reference price hours after a trade has occurred, will require a batch process whereby most firms will be sending an end-of-day reference price file to their clearing partners for producing customer confirmations. The concept of true straight-through-processing, a long standing industry goal, dies here. Additionally, the clearing firms themselves may have their own challenges, as they will now have to accept an end-of-day file that will need to be batch processed prior to the creation of the confirmation.

TMC's clearing firm has already expressed its inability to perform this task, based on its current system architecture.

If the regulators are seeking to disclose mark-ups based on a defined set of variables, then the data already resides with both the MSRB and FINRA. Why would it be appropriate to delegate the calculation to each firm when one central party already has all the data and can readily calculate the value? By having the regulators add the tag to its existing pricing feed, thousands of firms would be spared the burden of attempting to integrate systems and independently calculate a reference price. As the price could be disseminated in near real-time, assuming an appropriate time parameter, this would eliminate the complexity of adding batch processing to the clearing process. Furthermore, as the regulator mines the data, the algorithm could be adjusted to changing markets without tasking thousands of firm to coordinate systems. Similarly, if the trades were truly riskless, the cost basis of each trade would be known at the time of execution and could be easily added to a trade report or clearing ticket and thus promote the benefits of straight-through-processing.

While the goal of disclosing riskless principal mark-ups is laudable, the current proposal's attempt to define this type of transaction is too general. By inadvertently including risk trades, using a broad time frame definition, a customer will never have an apples to apples comparison when reviewing a trade confirm. We believe greater examination of definitions, surrounding transaction types such as bids wanted and true matched trades when buying for customers, will provide a more reasonable basis for defining a riskless trade. Furthermore, the economics of having a decentralized process whereby each dealer is responsible for determining either a reference trade price or mark-up value, would be costly, complex, and cause friction for the efficient settlement of trades.

We greatly appreciate the opportunity to respond and are available for any further conversations.

Sincerely,

Thomas S. Vales
Chief Executive Officer

FINANCIAL INFORMATION FORUM

5 Hanover Square
New York, New York 10004

212-422-8568

Via Electronic Delivery

December 11, 2015

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

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

Re: MSRB Notice 2015-16 - Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers; FINRA Notice 15-36 - FINRA Requests Comment on a Revised Proposal Requiring Confirmation Disclosure of Pricing Information in Corporate and Agency Debt Securities Transactions.

Dear Mr. Smith and Ms. Asquith,

The Financial Information Forum (FIF)[1] would like to take this opportunity to comment on MSRB Notice 2015-16 and FINRA Notice 15-36 ("Proposals"). The FIF Back Office Committee ("FIF") has reviewed the proposals from an implementation perspective. We understand the intent of the proposals is to provide retail investors with insight and transparency into transaction costs and dealer compensation associated with their trades. We believe these proposals create significant implementation challenges to all dealers of municipal, corporate and agency debt securities, and may cause unintended consequences. FIF's comments on both proposals are limited to considerations related to implementation of the alternatives outlined in each of the proposals, and do not address policy issues. *This letter should not be interpreted as an endorsement or recommendation for either a mark-up or reference price on retail customer confirmations.*

Alignment of MSRB and FINRA is Imperative

As noted in our previous Comment Letter[2], FIF members reiterate the request for MSRB and FINRA to take a coordinated approach in their rule making and requirements on this initiative. While the intent of

[1] FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the securities industry across the order lifecycle. Our participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

[2] FIF Comment Letter on MSRB Notice 2014-20 and FINRA Notice 14-52; submitted January 20, 2015.

these new proposals is similar, to provide added transparency to retail[3] customers through additional disclosure on the customer confirmation, there are significant differences between the most recent MSRB proposal to require mark-up information and the FINRA proposal to require dealers to provide reference pricing. The obvious differences include: the timeframe for triggering disclosure (MSRB's two hour window vs. FINRA's same trading day), data required to be disclosed on the confirmation (dealer mark-up on prevailing market price expressed as a percentage vs. differential between price to the customer and the member's reference price.) Each of these approaches will vary in implementation costs and ongoing operational costs.

Additionally, while we prefer to limit the scope of this disclosure to address only "riskless" principal trades, if the regulators intend to broaden the scope of the requirements in the future (for example, expand the focus from riskless principal to include all principal trades), FIF members wish to avoid a double build-out and would prefer that all requirements be addressed within the same initiative. From an implementation perspective, incremental steps result in increased costs.

FIF members urge MSRB and FINRA to be fully harmonized in any resulting regulations, as we expect that costs would increase exponentially if there are significant variations between MSRB and FINRA rules, as well as extended lead times for implementation.

Limited Resources

It is important to understand that in most cases, the same resources within a firm are responsible to effect the necessary changes in both the TRACE and the MSRB data capture and confirmation processes. Implementation of T+2 for corporate and municipal bonds will rely largely on the same skilled and knowledgeable subject matter experts to conduct the analysis, and make and test the operational and technical changes. We urge the regulators to consider the burden placed on these finite resources, given the array of regulatory initiatives planned for 2016 and 2017.[4]

While neither FINRA nor the MSRB have provided timeframes for implementation of these new disclosure requirements, overlapping timeframes with the industry's preparations for T+2 settlement must be avoided. Chair White has registered her strong support for T+2 requesting that SROs finalize schedules of rule changes such that the industry could complete its work no later than the third quarter of 2017. Accordingly, MSRB has committed to adopt rule changes by Q2 2016 to meet the targeted completion date. The many initiatives involved to reach T+2 will be resource intensive and costly. Whatever approach is agreed by the regulators to address confirmation disclosure, we request that the effective dates be scheduled to allow sufficient time for implementation after T+2 has been completed.

Significant Implementation Challenges

In addition to urging that regulators develop an implementation timeline with due consideration being given to T+2 and other regulatory initiatives that will draw upon the same finite resources, FIF has identified the following implementation challenges with the FINRA and MSRB proposals that it believes should be addressed in any final proposal submitted to the Commission for approval.

[3] FIF members appreciate the consistent approach proposed by both MSRB and FINRA to identify retail customers as those that are "not institutional" as defined by MSRB G-8 or FINRA 4512(c), or not a proprietary account. Inclusion of institutional accounts under these proposals would cause serious disruption to the automated confirmation process (e.g. Omgeo).

[4] Several TRACE and MSRB changes are in progress and must be completed by May 23, 2016. Most recently, additional changes to TRACE have been proposed by FINRA for implementation July 18, 2016. Pending adoption of T+2 rule changes in Q2 2016, work must start immediately following current initiatives to meet a Q3 2017 target for T+2.

Straight Through Processing Disruptions

Using the full trading day window to determine if a trade was done risklessly will negatively impact straight-through processing in those firms that currently produce customer confirmations at the time of the trade. There has been a concerted effort in recent years to streamline and automate, and this requirement will break the process that has taken years to achieve.

- Dealers will need to hold up generating a retail trade confirmation to identify any possible related principal (inter-dealer) trades in the same security, on the same side. Principal transactions may have been executed either before or after the customer trade, or both. In any case, a process must be developed to capture trades that are potentially related and to identify specifically which trades should be applied to the calculation to be included on the confirmation. Manual intervention may be required to ensure the appropriate trades are selected; that is, that the principal trades identified are those most closely aligned to the riskless trade and representative of the prevailing market.
- If the same-day trading window is ultimately used in any resulting requirements, limiting the search to principal trades that *preceded* the customer trade would be preferable. Although this does not eliminate the potential need for manual intervention, it would not require the confirmation process to be deferred until end-of-day.
- There are firms that generally use a batch cycle to produce "retail" confirms, but leverage the real-time "institutional ID" process[5] to generate confirms for their high net worth clients who utilize third party custodians, for example. The need to place the added information on the ID confirmation for these clients would seriously disrupt the process and cause widespread consequences. While a follow-up paper confirmation could be produced for these high net worth individuals, in all likelihood, neither the investor nor the custodian wants to manage the paperwork.

Leveraging TRACE/MSRB Reference Prices

There are pros and cons to utilizing a reference price made available by FINRA or MSRB, as discussed in the proposals. Some uniform set of business rules would need to be established to determine exactly the criteria for identifying which trades should be included in the reference price calculations.

- Pros
    - For firms utilizing a batch process, this would be straightforward to implement; assuming an end-of-day feed were made available by MSRB and FINRA prior to 6PM (ET), this would allow most firms time to include the information in their confirmation processes.
    - This would eliminate the need for each firm to build the "matching engine" required to identify transactions representing contemporaneous cost or related principal transaction(s).
    - This would reduce the significant burden and expense on smaller firms, particularly those that rely on third-parties for clearing and/or transaction processing.[6]
    - This approach would provide consistent reference pricing across the industry.
    - Customers would have confidence in market transparency if the prevailing market or reference prices were obtained from FINRA or MSRB.

[5] See Footnote 3.

[6] Some third-party firms such as clearing firms and other service providers have indicated they will not take responsibility, for both operational and legal reasons, to identify which trade(s) represent the principal trade(s) related to a riskless transaction; therefore, introducing brokers and client firms would need to provide their clearing firm or service provider with the appropriate reference price or contemporaneous cost, which may require matching principal transaction(s) to the riskless trade. Leveraging a feed made available by MSRB and TRACE was described by one clearing firm as the optimal approach, as it would be seamless to the introducing brokers, with an implementation cost less than half of the $500,000 estimated to capture contemporaneous cost or other reference price from the introducing broker. This estimate of $500K does not include the cost that would be imposed on the many introducing brokers, which are primarily smaller regional firms, to identify the matching trades.

- Cons
    - FINRA or MSRB reference prices would not reflect the circumstances of that particular customer trade.
    - Retail customers will not understand the nuanced-differences between their trade and the time-weighted average price of others in the market. The onus would be on the investment advisor to explain the differences, with the facts and circumstances of the other trades unknown to him/her.
    - For those utilizing a real-time confirmation process, dealers do not want to hold up the confirmation to obtain the TRACE or MSRB end-of-day reference price. Similar to the issues with delaying the confirmation until end-of-day to capture potential principal trades, firms would want to expedite the process by capturing the most recent price or set of prices available in real-time from TRACE or MSRB. However, in this real-time scenario, a same day "look-back" may not produce any trades in that security, particularly if the transaction were to occur early in the day. In that case, some other methodology must be agreed upon.

Calculating Mark-Up/Mark-Down for Purposes of Disclosure

The MSRB proposal would require dealers to include the dealer's mark-up or mark-down from the contemporaneous cost or the prevailing market price for the security on the customer confirmation. Dealers are required by MSRB G-30 fair pricing standards to perform diligence in determining the market value and reasonable compensation on any security at the time of proposing a bid or offer price. Following are the considerations regarding use of the "Prevailing Market Price" as the reference price from which the mark-up or mark-down would be calculated.

- Pro
    - A significant challenge is rooted in the fact that the large majority of municipal bonds trade infrequently. In most circumstances where there is no previous street-side trade execution or other transaction that may determine "contemporaneous cost" and no clearly identifiable "reference" trades, establishing a reasonable price and a fair mark-up is accomplished using many other inputs including: evaluated pricing, similar credits, market sector, transaction size, supply and demand considerations, and other relevant factors. However, because a reasonable method to determine the prevailing market price is required as part of the current business process, the prevailing market price and inputs to derive it should be readily available.
- Con
    - Despite the availability of a prevailing market price, FIF does not believe this price will be a clear metric for retail customers to understand. The inputs used to calculate the prevailing market price will not be disclosed on the confirmation, leading to a mark-up or mark-down based on a price with no context, which may confuse customers.

While the dealer's contemporaneous cost is perhaps more relevant for establishing the mark-up/mark-down in a *riskless trade*, for reasons discussed previously, it is significantly more difficult and more costly to capture. However, for purposes of establishing the mark-up/mark-down in a *principal trade*, the issues are far more complex. The mark-up on a bond includes profit along with the cost of doing business. Dealers are hedging positions to reduce their amount of risk. Disclosing the mark-up to the customer will not factor in any potential loss incurred on the hedge. The costs of operating the business and maintaining an inventory should also factor into the mark-up. These factors will not be clearly identifiable to the customer on the confirmation which misleads the customer to believe that the mark-up is full profit for the dealer. Because a mark-up may include multiple components such as sales credit,

desk credit, and compensation for risk in the case of a principal trade, FIF members believe presenting a percentage of the price differential on the confirmation will confuse retail investors.[7]

As we've stated previously in this letter, we are not endorsing either a mark-up or reference price to be disclosed on customer confirmations. There appears to be no clear consensus amongst FIF members or the industry as to which proposal is preferred. Regardless of which methodology is ultimately selected by the regulators for the purposes of disclosure, FIF members believe that only the dollar amount differential should be displayed, and should only be applied in cases where the dealer firms themselves establish the "reference price" being used (e.g. contemporaneous cost). In cases where a third-party price (TRACE, MSRB or some other form of derived price that is not directly linked to the customer trade) is displayed, a difference expressed in terms of percentage and/or dollar amount is meaningless and misleading, as it does not accurately reflect the mark-up or how the bond was priced to the customer.

MSRB and FINRA should consider that customers do not currently receive a similar percentage of price differential on their confirmations, as no other asset class requires the percentage to be disclosed. Additionally, including the percentage spreads on the confirmation will require significant programming, as market data and other information not normally passed from front office systems to back office systems will need to be accommodated. This will lead to increased costs and time to implement.

Other Concerns

Impact on Liquidity

One potential "unintended consequence" of this initiative is firms may be driven away from carrying inventory and toward conducting agency-only business. While FIF comments are typically limited to implementation issues, FIF is mentioning this risk due to the anticipated difficulty and cost of implementing the mark-up or reference price disclosure requirements, which could contribute, in part, to a firm's decision to limit its principal trading and market making activities. Retail investors may be negatively impacted, as investment advisors look to external markets, rather than internally, to buy and sell bonds for their clients.

Inability to "Look Through"

In many firms there will not be an ability to "look through" to principal trades on the other trading desks that may supply offerings or bids for retail investors. With separate P&Ls, and most often conducting inter-dealer business on completely separate platforms, the opportunity to identify the principal leg of trade may not be obtainable until late in the transaction life-cycle after all trades have been processed.

Time of Execution

FIF members expressed concern in placing the Time of Execution on the confirmation for two primary reasons: 1) it will be an additional expense to parse that information from trading platforms, as this is not typically carried through to the back office systems that generate the confirmations; and, 2) it will not be possible to adjust the Time of Execution properly in conjunction with any trade modifications, cancelations or corrections. While we understand MSRB's intent in requesting the Time of Execution on

[7] While FIF members fully understand the intent of this initiative is to disclose the full difference between the dealer's cost and the dealer's price to the customer, a simple and straightforward alternative would be to limit the disclosure on all retail customer confirmations to display only sales credit. This would provide increased transparency to retail customers in terms that are easily understood by the retail investor. The sales credit is known at time of the trade, it can be applied to any retail customer transaction regardless of a corresponding principal transaction, and is already passed on to the back office which would easily allow for the sales credit to be included on the customer confirmation with minor additional programming.

the trade confirmation is to support the investors' ability to look up the prices of similar trades on EMMA, the number of trades in each CUSIP listed on EMMA are so limited that investors will not have difficulty in ascertaining the prevailing market prices at or around the time of their trade. FIF members believe the Time of Execution is unnecessary information on a municipal bond confirmation, and it is not required on a confirmation for other security types.

Retail Confusion

In addition to the examples that have already been described, retail confusion may also be caused by the fact that these disclosures will only occasionally be provided; that is, they will apply to only certain "riskless" transactions. Furthermore, in response to the question regarding the form and format of the additional disclosure, FIF members believe that placing added information on a document separate from the confirmation will present additional challenges in bringing together documents that would be produced by separate systems. It would only add to customer confusion if the information was not delivered to the retail investor as one unit.

Summary

FIF believes this is a policy decision best left to the dealer firms to voice their opinions regarding trading and market making activities, and their positions and preferences with respect to additional disclosure on retail customer confirmations. Unfortunately, there appears to be no single solution that would accomplish the goals of full transparency, be easy for the retail investor to understand and straightforward to implement. Therefore, *FIF does not advocate or recommend the use of any particular method, but merely points out the implementation impacts of each approach.*

Again, we request that the implementation solutions for FINRA 15-36 and MSRB 2015-16 be consistent and realistic in terms of delivering information that is readily available, requiring limited or no manual intervention, and allowing the confirmation process to remain as automated as possible and processed in a timely fashion.

In conclusion, FIF would like to thank the MSRB and FINRA for providing the opportunity to comment on the proposed changes, and we support these efforts to establish a consistent, harmonized approach to transparency and disclosure.

Regards,

Darren Wasney
Program Manager
Financial Information Forum

EXHIBIT 5

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

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0100. GENERAL STANDARDS

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0150. Application of Rules to Exempted Securities Except Municipal Securities

(a) through (b) No Change.

(c) Unless otherwise indicated within a particular Rule, the following FINRA and NASD rules are applicable to transactions in, and business activities relating to, exempted securities, except municipal securities, conducted by members and associated persons: FINRA Rules 2010, 2020, 2060, 2111, 2122, 2150, 2210, 2212, 2232, 2261, 2268, 2269, 2320(g), 3110, 3220, 3270, 3280, 4120, 4130, 4210, 4311, 4330, 4360, 4510 Series, 4530, 5160, 5210, 5220, 5230, 5310, 5340, 8110, 8120, 8210, 8310, 8311, 8312, 8320, 8330 and 9552; NASD Rules IM-2210-2, 2340, 2510, 3050 and 3140.

(d) No Change.

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2000. DUTIES AND CONFLICTS

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2200. COMMUNICATIONS AND DISCLOSURES

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2230. Customer Account Statements and Confirmations

2232. Customer Confirmations

(a) through (b) No Change.

(c) A confirmation shall include the member's mark-up or mark-down for the transaction, to be calculated in compliance with Rule 2121, expressed as a total dollar amount and as a percentage of the prevailing market price if:

(1) the member is effecting a transaction in a principal capacity in a corporate or agency debt security with a non-institutional customer, and

(2) the member purchased (sold) the security in one or more transactions in an aggregate trading size meeting or exceeding the size of such sale to (purchase from) the non-institutional customer on the same trading day as the non-institutional customer transaction. If any such transaction occurs with an affiliate of the member and is not an arms-length transaction, the member is required to "look through" to the time and terms of the affiliate's transaction with a third party in the security in determining whether the conditions of this paragraph have been met.

(d) A member shall not be required to include the disclosure specified in paragraph (c) above if:

(1) the non-institutional customer transaction was executed by a principal trading desk that is functionally separate from the principal trading desk within the same member that executed the member purchase (in the case of a sale to a customer) or member sale (in the case of a purchase from a customer) of the security, and the member had in place policies and procedures reasonably designed to ensure that the functionally separate principal trading desk through which the member purchase or member sale was executed had no knowledge of the customer transaction; or

(2) the member acquired the security in a fixed-price offering and sold the security to non-institutional customers at the fixed price offering price on the day the securities were acquired.

(e) Definitions

For purposes of this Rule, the term:

(1) "agency debt security" shall have the same meaning as in Rule 6710(l);

(2) "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(cc);

(3) "arms-length transaction" shall mean a transaction that was conducted through a competitive process in which non-affiliate firms could also participate, and where the affiliate relationship did not influence the price paid or proceeds received by the member; and

(4) "non-institutional customer" shall mean a customer with an account that is not an institutional account, as defined in Rule 4512(c).

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