



January 20, 2015

*Submitted electronically*

Marcia E. Asquith  
Office of the Corporate Secretary  
Financial Industry Regulatory Authority  
1735 K Street, NW  
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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<sup>1</sup> (“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”).<sup>2</sup> 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.

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<sup>1</sup>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.

<sup>2</sup>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.<sup>3</sup>

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.

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<sup>3</sup>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.<sup>4</sup> 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.<sup>5</sup> 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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<sup>4</sup>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).

<sup>5</sup>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 to 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.<sup>6</sup> 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.<sup>7</sup>

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.

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<sup>6</sup>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.

<sup>7</sup>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 cancellation 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.<sup>8</sup> 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.<sup>9</sup> 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.

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<sup>8</sup>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).

<sup>9</sup>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).<sup>10</sup> Once achieved, DTCC has recommended a pause and further assessment of industry readiness and appetite for a future move to T+1.<sup>11</sup> 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.

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<sup>10</sup>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).

<sup>11</sup>*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](http://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."<sup>12</sup> 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

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<sup>12</sup>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



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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.

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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  
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