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
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Financial Services Roundtable

With a copy to:

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