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.

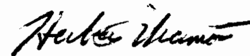
Harming the relationship between the customer and the bond dealer, and having bond dealers reduce or eliminate retail trades, all for the sake of this misguided Proposal, simply does not add any benefit to the retail customer.

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