



VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

December 11, 2015

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
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:

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 Institute⁴ (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-term 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

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

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,

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

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