



1909 K Street NW • Suite 510
Washington, DC 20006
202.204.7900
www.bdamerica.org

December 11, 2015

Submitted Electronically

Marcia E. Asquith
Senior Vice President and Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

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

RE: **FINRA Regulatory Notice 15-36: FINRA Requests Comment on a Revised Proposed Rule Requiring Confirmation Disclosure of Pricing Information in Corporate and Agency Debt Securities Transactions**

MSRB Regulatory Notice 2015-16: Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers

Dear Ms. Asquith and Mr. Smith:

On behalf of the Bond Dealers of America (“BDA”), I am pleased to submit this letter in response to Financial Industry Regulatory Authority (“FINRA”) Regulatory Notice 15-36 and Municipal Securities Rulemaking Board Regulatory Notice 2015-16 (the “Notices”), requesting comment on proposed rules to require the disclosure of market or pricing reference information on retail-trade confirmations for municipal, corporate, and Agency fixed-income securities. BDA is the only DC based group representing middle-market securities dealers and banks focused on the United States fixed-income markets and we welcome this opportunity to present our comments on the Notices.

BDA believes that increasing transparency by providing an additional pricing disclosure to retail investors could be beneficial to the marketplace if it can be done at reasonable cost to dealers by utilizing and leveraging the transaction information that regulators are required to receive after each transaction. Additionally, to be valuable, the rule must be understood by retail investors. BDA strongly urges regulators to pursue a harmonized rule that represents the least cost, least complex, and most understandable disclosure method. BDA believes neither the MSRB nor FINRA have put forth a proposed rule that fulfills those criteria or enables retail investors to compare their trading costs to other retail investors in the market. Also, BDA does not believe that estimating the regulatory cost impact of this rule is even possible at this point.

BDA's Markup Disclosure Recommendations

- **Methodology:** BDA recommends that FINRA and MSRB work with dealers to develop a lower-cost solution that leverages the transaction data that is centrally reported to TRACE and EMMA. This would allow for retail confirmations to include a price comparison to the average inter-dealer daily trade price.
- **Scope:** The disclosure should be required for retail trades where the dealer has entered into a same-day principal transaction on the same side as the retail investor and the quantity of the dealer principal trade is the same size or greater than the retail trade.
- **Timeframe:** The disclosure should be based on the full trading day basis outlined in FINRA's notice in order to minimize technology costs and operational complexity associated with a shorter time period.
- **Disclosure Format:** The disclosure should be displayed in dollar terms or as a percentage of the markup relative to the inter-dealer price.
- **Harmonize:** BDA strongly urges regulators to publish a fully harmonized rule. BDA members have spent an enormous amount of time and resources reacting to and researching solutions to the 2014 proposed rules and the current proposals.
- **Reduce Complexity:** Broker-dealers urge regulators, as part of a coordinated rulemaking process, to focus on proposing the least complex, least-cost methodology that best achieves the stated goals of the regulation.

BDA still believes these rules are based on a fundamental misconception of market risk. Dealers have multiple bond positions in inventory. Some bonds are held for a day or less and others are held for several days or weeks because investor demand does not materialize to the extent that the dealer expected due to basic market dynamics. Unless there is an existing contra side order, a dealer is at risk when it purchases a security. Therefore, BDA would prefer that regulators publish a truly "riskless principal" rule for fixed income, similar to SEC Rule 10b-b, that applies to equity transactions, where dealer cost basis is disclosed and the trade is truly "riskless."

BDA appreciates the improvements that regulators have made to the proposals.

BDA appreciates the improvements that regulators have made to the confirmation disclosure proposals compared to the 2014 proposals.

Retail Focus

The Notices are now explicitly focused on retail customers. This was a significant concern for BDA members that routinely transact with institutional customers in trade sizes that would have been considered ‘retail size’ by the previously proposed rules. A retail-account-focused rule proposal is superior. Although, there are some concerns with the potential application of this rule to smaller institutions that are below the quantitative thresholds.

Secondary Market Trades

Additionally, BDA believes that the Notices are improved by the exclusion on new issue transactions at the “list-offering price” from the scope of the rule proposals. As MSRB’s Notice notes, in these instances, the offering documents contain ample information, including the public offering price and underwriter compensation.

Link to Trading Data Pages

BDA believes leveraging the data reported to TRACE and EMMA and increasing awareness of the comprehensive pricing information available on these sites is important. The proposals do seem to differ on where on the website the investor would be directed to. BDA believes a general link to the main page of EMMA and TRACE would be operationally easier to achieve than directing investors to a security specific page.

BDA believes the proposals are too complex.

Specifically, the Notices outline two different methodologies for computing the retail confirmation disclosure and for the format of the disclosure. The MSRB proposes to require a retail confirmation disclosure of a markup relative to the prevailing inter-dealer price at the time of the retail trade. Alternatively, FINRA has proposed a requirement for a confirmation disclosure based on the differential between a retail transaction price and a dealer’s same day principal trade in the same security. BDA observes some unique challenges with each of the complex proposed methodologies.

FINRA’s complex methodology would require dealers, of all sizes, to implement a technologically intensive and expensive solution that would require significant new operational and trading systems to be put in place, including working with third-party service providers and vendors to create new and expensive solutions to accurately capture two associated trades executed on the same day and then transfer the differential onto a customer confirm. The complexity with MSRB’s alternative proposal is based on the possible ambiguity of identifying contemporaneous cost with enough certainty to put the

information on a customer confirmation. The common problem with the proposals is that they require dealers to create new systems, processes, and procedures to capture transaction data that is held already held and publicly disseminated by regulatory agencies.

In light of the unprecedented volume of new regulations impacting dealers in recent years, BDA believes that an overly complex, technologically intensive regulation must be avoided. Broker-dealers are required under FINRA and MSRB rules to abide by the highest standards of commercial honor. FINRA Rule 5310 and MSRB Rule G-18 require dealers to execute customer trades at prices that are “as favorable as possible under prevailing market conditions.” In addition, transactions must be executed for fair prices and commissions under FINRA Rule 2121 and MSRB Rule G-30.

In the past decade, mark ups in the fixed-income markets have been consistently narrowing. As FINRA notes in its proposal, the median mark up for a “retail-size” investment grade corporate bond transaction is 51 basis points. In 2012, the Securities and Exchange Commission’s reported that the average corporate bond mark up in 1999-2000 was 124 basis points. By contrast, according to the Investment Company Institute, the average annual bond fund expense fee was 70 basis points and the average front-load was 70 basis points in 2014.¹

The premise of this regulation is to ensure that, despite all of the existing rules and the associated enforcement of those rules all of which ensure quality execution and the public reporting of every trade to EMMA and TRACE that retail investors could derive additional benefits if they better understood dealer transaction-based compensation. BDA does not disagree with that notion, but BDA does disagree with the solution that regulators have proposed because it requires dealers to devote massive amounts of resources to comply when a simpler, less costly alternative exists.

BDA believes the FINRA proposal is too complex and will be too costly.

FINRA’s reference price approach is problematic primarily because it is too complex and will be too costly from a technology, compliance, and operational standpoint. As BDA discussed in its 2014 comment letter, redesigning dealer systems to capture a reference price is operationally intensive and will require a full system re-build for many dealers. This will be a significant cost burden, especially for smaller dealers that have fewer compliance personnel and less revenue to divert from core operations to fund growing technology and compliance budgets.

The reference price solution is more complex and this fact reduces the value of the disclosure to retail investors. The proposed “alternative methodology” for complex trades is a particular element that BDA views as far too complex. Retail investors may not understand the reference price disclosure in its simplest form. BDA believes that the disclosure will be significantly less well understood if differing methodologies are allowed for “complex” trades. These types of exceptions, including the exception for

¹ Investment Company Institute Fact Book 2014: http://www.icifactbook.org/fb_ch5.html#fees

‘material change provision’, will conceivably allow for different retail confirmation disclosures for the same exact trades depending on the judgment and chosen procedure of different dealers all executing different, but similar, trades and what principal transactions that dealer has entered into during the trading day. This design means that retail investors across the marketplace will receive inconsistently computed confirmations, thus reducing the value, clarity, and comparability of the disclosure to transactions in the marketplace generally.

Furthermore, BDA does not believe that a reference price disclosure will give retail investors a valuable indicator with which they will be able to understand transaction costs and dealer compensation in the market. Dealers enter into principal trades at various prices and quantities throughout the trading day. Therefore, the reference is not going to consistently be a valuable indicator for transaction costs in comparison to other investors in the marketplace transacting at the same time in the same security. In fact, it will be a confusing indicator because, unlike the inter-dealer prevailing price, it is a reference to where the market was and not what the current market price is or what the inter-dealer price is at the time of the retail investor trade.

For example, as BDA stated in its previous comment letter, a dealer may purchase bonds at 99 in a principal capacity and then enter into a sale, possibly hours after the initial transaction, at a 102 in full compliance with the dealer’s best execution responsibilities. At that point, another dealer could be executing comparable retail sales at 102.5 or 103 with a cost-basis (for disclosure purposes) of 101. BDA notes that the disclosure—by definition—is based on where the market was rather than on the actual market conditions at the time of the executed trade. This creates the opportunity for a highly misleading disclosure. In this instance, the dealer that filled the customer order at the superior market price will be required to disclose a larger markup than the dealer that filled the customer order at the inferior price. The potential impact on the market, especially the impact on liquidity, that could be caused by providing this misleading information to investors is currently unknown and should be studied fully for the benefit of investors and the marketplace.

The premise for the proposed regulation is to allow retail investors to have greater information about transaction costs and to allow retail investors to approach their broker informed with greater information about their transaction costs. BDA does not believe the dealer-reference price approach is the optimal method for providing the information to retail customers to inform that discussion.

BDA believes the MSRB’s methodology introduces significant new risks due to its ambiguity.

Of the proposed disclosure methodologies, BDA believes the central element of MSRB’s methodology, which proposes a mark up disclosure relative to the prevailing inter-dealer price at the time of the retail trade, is a step in the right direction because it attempts to limit technology and operational costs. The inter-dealer price would be used

to compute the required markup disclosure, in dollar terms and as a percentage, which would be displayed on retail confirmations.

BDA believes that the biggest uncertainty created by the MSRB's methodology would be with reliably and consistently ascertaining inter-dealer cost for computing and reporting the confirmation disclosure. MSRB's proposal contemplates a marketplace where inter-dealer price is readily observable and universally agreed upon. However, in certain instances, there may be a tightly distributed range of views amongst dealers for what inter-dealer cost is at a given point in time. This introduces the risk that an examiner could disagree with one trader's specific determination of the prevailing inter-dealer market price, which could lead to violations of MSRB and FINRA rules regarding accuracy of customer confirmations. This is a very serious concern with the MSRB approach.

BDA believes these risks could potentially be reduced, to a certain extent, through guidance. Specifically, dealers would benefit from guidance outlining what due diligence process and procedures would be required related to the documentation of the inter-dealer cost and how would those procedures fit within the existing due diligence and documentation requirements related to the best execution rules. Best execution rules allow for a range of acceptable trade prices to be considered if a thorough process for ascertaining market price is employed. BDA is concerned that differing views about prevailing market prices could give rise to serious and unnecessary violations of rules related to confirmation accuracy. Therefore, it would be useful to provide guidance that describes hypothetical transactions, in addition to what types of processes and documentation would be required.

If the premise of these rules is to foster greater understanding of dealer compensation and allow retail customers to understand execution quality versus other retail customers, the MSRB proposal may allow for that to take place with less complexity, and in a less costly way, than the FINRA proposal. BDA believes that the MSRB methodology would provide a more consistent and meaningful disclosure because retail investors would have the same reference element, the prevailing market price, and the disclosure would be more consistent for similar retail transactions executed at roughly the same time.

BDA strongly urges regulators to harmonize their rules.

Currently, the Notices outline two vastly different proposed rules. The worst possible outcome for dealers, especially smaller dealers, is two distinctly different final rules. Two different rules would mean a doubling of implementation and technology-cost burdens and would create a massive and unnecessary compliance burden for dealers on an ongoing basis. BDA understands that it is the intent of regulators to harmonize the proposals to the greatest degree possible. However, BDA wants to stress that a harmonized rule is absolutely essential, especially for smaller dealers who are already struggling with vastly higher compliance and technology costs as a result of new regulations.

FINRA's proposal notes that 70% of transactions in corporate credit are concentrated amongst 20 dealers. In light of the ongoing trend towards greater dealer consolidation, doubling the regulatory cost impact on dealers, especially smaller dealers, would likely accelerate the consolidation trend. Supporting greater consolidation of trading amongst the largest dealers at the expense of smaller dealers would be a perverse outcome for a rulemaking designed to allow retail investors to benefit from increased competition amongst dealers.

In addition to harmonization, BDA urges regulators to recognize that this is a significant rulemaking that will have a large impact on how dealers operate, from a trading, operations, and technology standpoint. Each time a proposal is put forth, dealers are required to assess the proposal as if it were a final rule. Dealers have to interact with operational, compliance, legal, trading, internal technology staff, and third-party vendors to assess the extent and cost of the potential systems upgrades, including the development costs of third-party vendor solutions. This is expensive and time consuming for firms with limited resources and limited staff. It is important for regulators to engage dealers and enter into robust discussions about the systems and technology impact and costs associated with this proposal in order for regulators to begin to understand the complexity and costs associated with the proposals. BDA previously recommended a feasibility study so that regulators could fully contemplate the costs associated with this proposal. BDA is disappointed that that study did not take place prior to these new proposals being published for comment.

BDA urges regulators to pursue the least complex, least-cost method by leveraging TRACE and EMMA data.

If regulators are determined to require a confirmation disclosure on a population of trades that is larger than purely "riskless principal" transactions, BDA recommends regulators develop a harmonized proposal based on the least complex, lowest cost proposal by using the centralized data that is already reported to TRACE and EMMA.

BDA recommends that regulators leverage the transaction data that they already hold to provide the type of retail confirmation disclosure the proposals are designed to create. Both the MSRB and FINRA have all the transaction data supplied to them throughout the trading day and are engaged in constant public price dissemination throughout the trading day. At a much lower cost to broker-dealers, and with much greater clarity, than the systems outlined in the Notices, FINRA and MSRB could compute the daily average inter-dealer price and require customer confirmations to include the differential (in dollar terms and as a mark up percentage) between the daily average inter-dealer cost price and the retail investor's transaction price. This would allow customers to better understand dealer compensation and would provide sufficient information for a customer to contact their dealer to discuss the execution of their trades.

Additionally, BDA would also like to note that, especially in the municipal securities market, the difference between a retail customer's cost and the inter-dealer

contemporaneous cost, the dealer's reference price, and the average daily inter-dealer cost would, in most cases, be minimal.

This method represents a more efficient way of delivering a confirmation disclosure. BDA is ready to work with regulators to improve the proposals and to discuss alternatives that would be less costly and deliver pricing information that would allow retail investors to be more informed about the marketplace.

Thank you again for the opportunity to submit these comments.

Sincerely,

A handwritten signature in blue ink that reads "M. Nicholas". The signature is written in a cursive, flowing style.

Michael Nicholas
Chief Executive Officer