FINRA
Financial Industry Regulatory Authority

November 14, 2016

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Via Email to rule-comments@sec.gov

Re: File No. SR-FINRA-2016-032 – Response to Comments

Dear Mr. Fields:

This letter responds to comments submitted to the Securities and Exchange Commission ("SEC" or "Commission") regarding the above-referenced filing, a proposed rule change to require members to disclose additional pricing information on confirmations of transactions in certain non-municipal fixed income transactions with retail customers.[1]

Background

FINRA is proposing to amend Rule 2232 (Customer Confirmations) to provide retail fixed income investors with additional information about the costs of their transactions. Specifically, the Proposal would require members to disclose to a non-institutional customer[2] the amount of mark-up or mark-down[3] the customer paid for a trade in a corporate or agency debt security,[4] if the member also executed one or more offsetting principal trades in the same security on the same trading day, on the same side of the market as the customer trade, which in the aggregate meet or exceed the size of the customer trade. Members would be required to

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1 Securities Exchange Act Release No. 78573 (August 15, 2016), 81 FR 55500 (August 19, 2016) (SR-FINRA-2016-032) ("Proposal").

2 The term "non-institutional customer" is defined in proposed Rule 2232(f)(4) (proposed rule provisions refer to the text of the proposed rule change, as modified by Amendment No. 1).

3 For ease of reference, unless otherwise noted, the term "mark-up" is intended to refer to mark-ups and mark-downs, collectively.

4 The terms "corporate debt security" and "agency debt security" are defined in proposed Rule 2232(f)(1) and (2), respectively.

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calculate the mark-up that is disclosed on a customer confirmation consistent with existing FINRA Rule 2121 and the supplementary material thereunder.

If a member's offsetting principal trade was with an affiliate and did not occur at arm's length, the member would be required to "look through" to the time and terms of the affiliate's trade to comply with the rule. However, mark-up disclosure would not be triggered under the rule by principal trades that a member executes on a trading desk that is functionally separate from a trading desk that executes customer trades, provided the member maintains policies and procedures reasonably designed to ensure that the functionally separate trading desk has no knowledge of the customer trades. In addition, the proposal would not require mark-up disclosure for bonds that are acquired by a member in a fixed-price offering and sold to non-institutional customers at the same offering price on the same day the member acquired the bonds.

The Commission received ten comment letters on the Proposal.[5] A majority of the commenters supported the overall goal of the Proposal—namely, to improve pricing transparency for retail customers in the fixed income markets.[6] However, the commenters raised a number of questions about how the Proposal would be interpreted or implemented, and some commenters disagreed with the Proposal's analysis of potential costs and benefits. The following are FINRA's responses, by topic, to the issues the commenters raised.

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5 See Letters to the Commission from Michael Nicholas, Chief Executive Officer, Bond Dealers of America, dated September 9, 2016 ("BDA Letter"); Norman L. Ashkenas, Chief Compliance Officer, Fidelity Brokerage Services, LLC, and Richard J. O'Brien, Chief Compliance Officer, National Financial Services, LLC, dated September 9, 2016 ("Fidelity Letter"); Mary Lou Von Kaenel, Managing Director, Financial Information Forum, dated September 9, 2016 ("FIF Letter"); Scott A. Eichhorn, Practitioner in Residence and Supervising Attorney, et al., Investor Rights Clinic, University of Miami School of Law, dated September 8, 2016 ("IRC Letter"); Hugh D. Berkson, President, Public Investors Arbitration Bar Association, dated September 7, 2016 ("PIABA Letter"); Manisha Kimmel, Chief Regulatory Officer, Wealth Management, Thomson Reuters, dated September 8, 2016, and September 19, 2016 ("Reuters Letter I" and "Reuters Letter II"); Sean Davy, Managing Director, Capital Markets Division, and Leslie M. Norwood, Managing Director and Associate General Counsel, Municipal Securities Division, Securities Industry and Financial Markets Association, dated September 9, 2016 ("SIFMA Letter"); and Robert J. McCarthy, Director of Regulatory Policy, Wells Fargo Advisors, LLC, dated September 9, 2016 ("Wells Fargo Letter"); and Memorandum to the Commission from Rick A. Fleming, Investor Advocate, SEC, dated November 7, 2016 ("SEC Investor Advocate Memo").

6 See BDA Letter at 1; Fidelity Letter at 2; IRC Letter at 1; PIABA Letter at 1; SIFMA Letter at 1; Wells Fargo Letter at 2; and SEC Investor Advocate Memo at 2.

FINRA is also aware that commenters raised related questions on a parallel MSRB filing that is currently pending with the Commission.[7] FINRA and the MSRB continue to coordinate to develop a consistent approach to confirmation disclosures across debt securities, to the extent appropriate. Accordingly, this letter includes reference to the MSRB Proposal where relevant.

Discussion

Trigger Requirements for Mark-Up Disclosure

Under proposed Rule 2232(c)(2), mark-up disclosure would be required in cases where a member purchased (or sold) a corporate or agency debt security in one or more transactions in an aggregate trading size that meets or exceeds the size of a sale to (or purchase from) a non-institutional customer on the same trading day as the non-institutional customer transaction. Four commenters discussed operation of the Proposal's triggering standard from various perspectives.

One commenter, PIABA, addressed potential gaming concerns created by a same-day trigger. According to PIABA, mark-ups should be disclosed on all customer trades, including trades sourced with bonds that a member has held in inventory for more than a day. If a same-day trigger is adopted, however, PIABA encouraged FINRA to issue additional guidance on the existing FINRA rules that would prohibit a firm from intentionally delaying a customer execution to avoid triggering mark-up disclosure.[8]

FINRA continues to believe that a same-day timeframe is an appropriate trigger for disclosure, and also expects it will use tools, including surveillance, to monitor for inappropriate gaming.[9] As PIABA noted in its letter, the Proposal makes it clear that a member could not delay a customer execution for the purpose of avoiding mark-up disclosure without running afoul of Rule 5310 (Best Execution and Interpositioning).[10] Rule 5310 imposes a duty on members to use reasonable diligence to ascertain the best market for a security and to buy or sell the security in such market so that the customer receives a price that is as favorable as possible under prevailing market conditions. Supplementary Material .01 to Rule 5310 emphasizes further that a member must make every effort to execute a marketable customer order that it receives fully and promptly. FINRA believes this existing guidance, coupled with FINRA's statements in the Proposal, is sufficiently clear to address the potential for gaming raised by PIABA.

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7 See Securities Exchange Act Release No. 787777 (September 7, 2016), 81 FR 62947 (September 13, 2016) (SR-MSRB-2016-12) ("MSRB Proposal") and associated comment file.

8 See PIABA Letter at 1-2 (incorporating PIABA's comment letter on a previous version of the Proposal that FINRA published for comment in Regulatory Notice 15-36).

9 The SEC Investor Advocate expressed strong agreement with the proposed same-day triggering timeframe. See SEC Investor Advocate Memo at 7.

10 See Proposal, supra note 1, at 55501 n.11.

Two commenters raised questions about the mechanics and potential complexity of the Proposal's same-day trigger. These commenters, FIF and Thomson Reuters, observed that members would likely encounter operational difficulties—and, hence, significant cost—if they must recode their systems to keep track of customer trades, identify offsetting principal trades, which could occur later in the day than the customer trade, and apply mark-up disclosures to the subset of customer trades that satisfy the Proposal's triggering requirements.[11] Thomson Reuters noted that the Proposal includes guidance for firms that may seek to avoid these operational costs by choosing to provide mark-up disclosure more broadly, for example to all retail trades, although it suggested members may be hesitant to make that choice unless they can include statements on confirmations to explain or qualify the nature of the disclosed mark-up.[12]

As FINRA discussed in the Proposal, it recognizes that members could incur costs to identify customer trades subject to the Proposal's disclosure requirements. The Proposal included particular recognition of the fact that the potentially forward-looking element of the same-day trigger could be difficult to implement.[13] Nevertheless, FINRA stated in the Proposal and continues to believe that disclosure based on a same-day trigger would deliver important benefits associated with increased pricing transparency. In addition, the Proposal recognized the possibility that members can address this particular implementation burden by providing mark-up disclosure more broadly. FINRA included guidance in its Proposal that was intended to facilitate the timing of mark-up calculation for firms that made such a choice,[14] and this letter provides further facilitating guidance below. This letter also addresses below the request from Thomson Reuters and others to provide explanatory or qualifying statements concerning disclosed mark-ups.

Finally, SIFMA requested clarification on the scope of the same-day trigger requirements. Specifically, SIFMA sought confirmation for its interpretation that the Proposal requires disclosure only in cases where a customer trade has an offsetting principal trade.[15] SIFMA is correct that there must be offsetting customer and principal trades for the Proposal to be triggered, and FINRA has submitted Partial Amendment No. 1 in part to ensure rule text clarity on this point, consistent with FINRA's original description of the Proposal.[16] For

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11 See FIF Letter at 2, 4; Reuters II Letter at 3. In discussing the operation of the Proposal's same-day trigger, the FIF Letter included a statement that appears to characterize the functionally separate trading desk exception, described above, as an exception to the "look through" requirement, also described above. FINRA notes for clarification that these are separate provisions of the Proposal, intended to operate independently of each other. It is possible that both provisions may be applicable to the same trade; however, each provision would need to be analyzed and applied on its own.

12 See Reuters II letter at 2-3.

13 See Proposal, supra note 1, at 55505.

14 See Proposal, supra note 1, at 55506 (discussing intra-day confirmations).

15 See SIFMA Letter at 8.

16 See, e.g., Proposal, supra note 1, at 55500 (beginning the description of the Purpose of the Proposal by stating that it would require mark-up disclosure for customer trades "if

example, if a member purchased 100 bonds at 9:30 AM, and then executed three customer buy orders for 50 bonds each in the same security on the same day without purchasing any more of the bonds, the Proposal would require mark-up disclosure on two of the three trades, since one of the trades would need to be satisfied out of the member's prior inventory rather than offset by the member's same-day principal transaction. Members would be permitted, as SIFMA requested,[17] to develop reasonable policies and procedures to identify and account for offsetting trades that trigger the Proposal, provided the member applies those policies and procedures in a consistent manner. Also, as discussed throughout the Proposal and this letter, members may voluntarily decide to provide mark-up disclosure more broadly if they find it beneficial to do so.

Determination of Prevailing Market Price ("PMP")

Under the Proposal, mark-ups would be disclosed on confirmations as a total dollar amount, i.e., the dollar difference between the customer's price and the security's PMP, and as a percentage amount, i.e., the mark-up's percentage of the security's PMP. Members would be required to determine a security's PMP in compliance with Rule 2121 and the supplementary material thereunder, including Supplementary Material .02, which provides detailed step-by-step guidance on how to determine PMP for fixed income securities.

Seven commenters—BDA, FIF, PIABA, Thomson Reuters, SIFMA, Wells Fargo, and the SEC Investor Advocate—addressed the Proposal's use of PMP, determined in accordance with Rule 2121, as the reference price for purposes of mark-up disclosure. These comments focused primarily on the feasibility of automating PMP determination consistent with Rule 2121, although they raise several other interpretive issues as well. Broadly speaking, there are two primary issues raised in the comments: the permissible time of PMP determination, and the need to determine PMP consistent with Rule 2121.

Time of PMP Determination

Two commenters sought clarification on the time that PMP and any applicable mark-up must be determined. Wells Fargo specifically asked whether FINRA would adopt the guidance that the MSRB included in its proposal concerning PMP determination at the time a member begins the confirmation generation process.[18] SIFMA similarly suggested that the Proposal

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the member also executes one or more offsetting principal transaction(s) on the same day as the customer trade, the aggregate size of which meets or exceeds the size of the customer trade"). For added clarity, FINRA submitted Partial Amendment No. 1 in part to add the word "offsetting" to the trigger language in proposed Rule 2232(c)(2) to conform the rule language to the language used to discuss the trigger in the filing, cited in the previous sentence. FINRA notes, however, the Proposal is not meant to be drawn more narrowly to apply only to "matched trades," as the SIFMA Letter might suggest. To the extent SIFMA's use of the term "matched trades" is meant to imply that the principal and customer trade legs must both be known to the member when it arranges the trades, it would not accurately characterize the scope of the Proposal.

17 See SIFMA Letter at 8.

18 See Wells Fargo Letter at 3.

should allow PMP determination at the time of trade.[19] SIFMA further requested clarification that, in cases where members determine PMP at the time of the trade, they should not be required to cancel and resend a confirmation with a newly calculated mark-up figure based on the occurrence of a subsequent transaction or event that would otherwise be relevant to determining PMP under Rule 2121.[20]

FINRA agrees with the guidance set forth in the MSRB Proposal on PMP determination at the time of confirmation generation, and incorporates it here. Specifically, as Wells Fargo requested, FINRA confirms that members may maintain real-time, intra-day confirmation generation processes. Consistent with the MSRB Proposal, a member may determine PMP, as a final matter for disclosure purposes, based on the information the member has available to it as a result of reasonable diligence at the time the member inputs the PMP and associated mark-up information into its systems to generate a confirmation.[21] FINRA also would not expect members to send revised confirmations solely based on the occurrence of a subsequent transaction or event that would otherwise be relevant to PMP determination under Rule 2121.[22]

Adherence to Rule 2121 Guidance

Beyond the question of when PMP may be determined for confirmation disclosure purposes, several commenters argued against the Proposal's requirement to calculate mark-ups consistent with FINRA Rule 2121 and the supplementary material thereunder. According to SIFMA, it is "simply unworkable" to automate the guidance set forth in Rule 2121 in a manner that would allow members to calculate and disclose mark-ups on a systematic basis.[23] Similarly, BDA stated that the guidance in Rule 2121 is not easily converted to the automated, operational

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19 See SIFMA Letter at 5 (discussing whether PMP could be automated, presumptively at the time of trade), 7 (requesting assurance that members may base mark-up disclosure on information available at the time of the transaction).

20 See id. at 8.

21 See MSRB Proposal, supra note 7, at 62955. FINRA will conduct surveillance to protect against potential gaming of this guidance, as it will with other elements of the Proposal. See supra note 10 and corresponding text. For example, FINRA would find it inconsistent with the Proposal, associated guidance, and potentially other FINRA rules as well if a member manipulated the order or timing of its trades to result in more favorable PMP determinations.

22 See MSRB Proposal, supra note 7, at 62955. FINRA recognizes that by allowing members to determine PMP at the time of confirmation generation, a mark-up disclosed on a confirmation may not reflect subsequent trades that could be considered "contemporaneous" under existing Rule 2121 guidance. However, FINRA does not believe it is necessary to make a formal distinction between PMP determination for disclosure purposes as opposed to other regulatory purposes, as requested by SIFMA. See SIFMA Letter at 5-6, 7.

23 See SIFMA Letter at 5-7.

framework that will be required to comply with the Proposal.[24] BDA pointed specifically to the steps in the Rule 2121 guidance that require members to consider prices for "similar securities" when there is no relevant trade or quotation information for the particular security being transacted.[25] And FIF questioned the use of contemporaneous transactions executed by the member in the same security—the presumptive PMP under the first step of the Rule 2121 guidance—given the possibility of intra-day price swings.[26]

FINRA continues to believe that mark-up disclosure under the Proposal should be based on Rule 2121 guidance. FINRA notes that BDA, while commenting on the potential complexity of automating Rule 2121 guidance, nevertheless acknowledged that the principles and processes that guide fair pricing assessments—i.e., Rule 2121—are an appropriate guide for the confirmation disclosure process.[27] FINRA's proposed approach is also supported by the SEC Investor Advocate.[28] Still, FINRA recognizes the potential challenges involved in implementing the Proposal and has extended the implementation period to allow members more time to establish systems and processes to comply with the Proposal, as discussed in more detail below. FINRA has also engaged in additional firm outreach and analysis, as suggested by BDA,[29] and will provide members with interpretive guidance during the implementation process as necessary.

As an initial matter, FINRA believes it is important to reiterate a point it made in the Proposal—namely, that it expects a very significant percentage of the trades that require mark-up disclosure to have relatively close-in-time offsetting principal trades, which would presumptively establish PMP under the first step of Rule 2121.[30] As a result, FINRA believes that the Proposal's reliance on Rule 2121 should not present logistical operational challenges to the degree argued by commenters. In addition, FINRA believes that the Rule 2121 guidance is appropriate given that members have been subject to it for ten years and it has provided a

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24 See BDA Letter at 3.

25 See id. at 3-4.

26 See FIF Letter at 6-7. FIF argues that "the mark-up/mark-down should be calculated 100% of the time from PMP, which should be extremely close to the contemporaneous cost at least 82% of the time." See id. at 7. FIF does not make clear how it believes PMP should alternatively be determined, if not by presumptive reference to contemporaneous costs or proceeds. FIF suggests that an inter-dealer transaction that occurs between a member's principal trade and customer trade may provide a more reasonable basis for PMP calculation than the member's principal trade, although this approach already may be permissible under existing Rule 2121 guidance where the dealer has established that its cost or proceeds (from its principal trade) are no longer contemporaneous.

27 See BDA Letter at 4.

28 See SEC Investor Advocate Memo at 7-9.

29 See BDA Letter at 4.

30 See Proposal, supra note 1, at 55502 n.15 (citing recent trade data and concluding that firms will typically use their contemporaneous costs as PMP).

consistent, prescriptive framework for PMP determination. FINRA believes this will foster more comparable mark-up disclosures across firms.[31]

However, FINRA does recognize that members may rely on reasonable policies and procedures to facilitate PMP determination, provided they do so consistent with Rule 2121. Specifically, FINRA believes that members could develop policies and procedures to address the steps of Rule 2121's step-by-step guidance that SIFMA identified as inherently subjective and, as a result, not technologically feasible to automate.[32] For example, members could make reasonable judgments about how they will establish contemporaneous cost or proceeds at the preliminary stage of the Rule 2121 analysis in cases where the member has multiple principal trades that offset one or more customer trades subject to disclosure. FINRA previously provided detailed guidance to illustrate the average weighted price or last price methodologies that might be appropriate in this scenario.[33] A member could also employ a methodology to adjust contemporaneous cost and proceeds in cases where the member's offsetting trades that trigger disclosure under the Proposal are both customer transactions. This approach, which is discussed in detail in the MSRB Proposal, would allow the member to avoid "double counting" in the mark-up and mark-down it disclosed to each customer.[34] FINRA does not, however, believe additional adjustments to contemporaneous cost determinations, such as adjustments to reflect the size or side of a contemporaneous trade, as SIFMA requested, are consistent with Rule 2121.[35]

A member might also look to develop reasonable, objective criteria to apply the subsequent steps of the Rule 2121 guidance at a systematic level. Whether a transaction is

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31 See SIFMA Letter at 3-4 (raising concerns about customer confusion caused by variability across firms' approach to mark-up disclosure); see also Wells Fargo Letter at 3 (arguing that confusion might arise due to lack of uniformity in how firms determine PMP).

32 See SIFMA Letter at 5. FINRA notes that the guidance contained in this letter is not intended to convey that FINRA believes a member's PMP determination under Rule 2121 must be fully and strictly automated.

33 See Regulatory Notice 15-36, attached as Exhibit 2d to the Proposal, at 3-4 and Attachment B.

34 See MSRB Proposal, supra note 7, at 62954.

35 As FINRA noted in Regulatory Notice 15-36, size adjustments should not be necessary where mark-up disclosure requirements apply to retail customer trades that are offset by principal trades that, at least in the aggregate, meet or exceed the size of the customer trade. See Regulatory Notice 15-36 at 4 n.10. To the extent SIFMA requested clarity about permissible adjustments to contemporaneous cost to reflect the side of the transaction, FINRA notes that the Proposal is triggered when a member executes offsetting principal and customer trades on the same side of the market. In other words, FINRA does not believe the contemporaneous cost of a principal transaction should be adjusted based on the side of the transaction when the customer trade necessarily occurs on the same side of the market.

"contemporaneous," whether there is trade or quotation activity in a subject or similar security, and what economic models provide about the price of an illiquid security are all judgments that could be documented up front with the requisite assumptions explained in a member's procedures. To be sure, FINRA recognizes that these steps involve potentially subjective judgments, such as the relative weight of trade or quote activity in a given security, or the number or type of characteristics a different security must share with a given security to be considered "similar." However, based on FINRA's outreach to firms and its own experience with market data, FINRA believes there are ways to represent such subjective judgments with objective logic that could be documented and applied consistently through reasonable policies and procedures.

FINRA understands that many members already have in place some systematic approach to fixed income pricing that allows them to provide traders with automated pricing information or to run compliance checks against the prices that traders use to mark their inventory each day. It is FINRA's belief that these current systems consider many of the same information inputs found in Rule 2121 guidance, although perhaps not to the same extent or in the same order that is prescribed by the Rule. FINRA is also aware that some members or other market participants maintain or offer systems that evaluate trade and quote information for both a given security and similar securities, among other factors; while these systems may not do so today exactly as set out in Rule 2121, they nevertheless illustrate the possibility for programming the kinds of decision making required by Rule 2121. Accordingly, FINRA believes Rule 2121 is subject to automation without the need for the "artificial intelligence" that SIFMA suggested it would require.[36]

As suggested in the previous paragraph, FINRA recognizes that members may prefer to engage third party service providers to document and perform the steps of the Rule 2121 analysis, particularly those steps that look beyond a firm's own transaction history to more broadly available information. Members would not be prohibited from doing so under the Proposal. However, as those members would retain compliance responsibility, it would be incumbent on them to perform the due diligence necessary to ensure that third party service providers were providing them with figures that were determined consistent with Rule 2121. And of course, members would be expected to perform regular reviews of their policies and procedures for mark-up disclosure—whether the procedures document steps taken within a member's own operations or the member's oversight of third party vendors—to ensure they are adequate, appropriate, and consistently applied.

FINRA recognizes members may have more detailed, specific implementation questions if the Proposal is approved and FINRA is committed to working closely with the industry and MSRB during the implementation period to issue further guidance as necessary.[37] FINRA also is extending the proposed implementation time to 18 months.

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36 See SIFMA Letter at 6.

37 See Proposal, supra note 1, at 55502 (committing to issuing additional guidance as necessary with respect to the application of Rule 2121 to specific scenarios).

Use of Explanatory or Qualifying Language on Confirmations

Four commenters requested guidance on members' ability to add explanatory or qualifying descriptions of the mark-up figure that would be disclosed on customer confirmations under the Proposal. Two of these commenters, Fidelity and SIFMA, stated that members should be able to label disclosed mark-ups as "estimated" or "approximate."[38] SIFMA further asked whether members could provide additional explanation of the mark-up figure on confirmations, noting, for example, that PMP determination may vary across firms and thus may result in a lack of comparability or consistency in disclosures, especially for thinly traded securities.[39] SIFMA and Thomson Reuters also noted that members should be able to state on confirmations that the disclosed mark-up does not necessarily reflect a member's exact profit or loss for the transaction.[40] Similarly, Wells Fargo contended that members should be allowed to mitigate potential customer confusion by explaining on confirmations that firms may apply Rule 2121 differently to determine PMP, and that the components of a mark-up may vary depending on the amount of risk a firm assumed to satisfy a customer order.[41]

FINRA recognized in the Proposal that the determination of PMP for a particular security may not be identical across firms. Accordingly, FINRA stated its expectation that members have reasonable policies and procedures in place to establish PMP and that members apply these policies and procedures consistently across customers.[42] FINRA does not believe that members should be permitted to label the required mark-up disclosure as an "estimate" or an "approximate" figure, as such labels have the potential unduly to suggest an unreliability of the disclosures or otherwise diminish their value. However, FINRA believes that a member would not be prohibited as a regulatory matter from including language on confirmations that provides explanation of PMP as a concept, or provides detail about the member's methodology for determining PMP (or notes the availability of information about methodology upon request), provided such statements were accurate. In response to commenters' requests for FINRA to provide standardized or sample disclosures that would be appropriate under the Proposal,[43] FINRA will engage with members should the Proposal be approved to evaluate the potential need for and use of such guidance.

Time of Trade and TRACE Link Requirements to Harmonize With the MSRB Proposal

Four commenters addressed FINRA's statement in the Proposal that it intends to submit an additional filing to require members to add disclosures to non-institutional confirmations of the time of trade and a link to trade data reported to FINRA's Trade Reporting and Compliance Engine ("TRACE"). Three of these commenters asked that FINRA conform its forthcoming

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38 See Fidelity Letter at 3; SIFMA Letter at 4.

39 See SIFMA Letter at 4.

40 See SIFMA Letter at 4; Reuters II Letter at 3.

41 See Wells Fargo Letter at 4-5.

42 See Proposal, supra note 1, at 55502.

43 See Fidelity Letter at 3; SIFMA Letter at 4.

filing to parallel requirements included in the MSRB Proposal.[44] The SEC Investor Advocate also stated generally that it is important for FINRA and the MSRB to adopt consistent rules related to confirmation disclosure.[45]

FINRA agrees that it is important to harmonize these additional disclosure requirements with the MSRB. Accordingly, FINRA has submitted Partial Amendment No. 1 to propose requirements which it believes are identical to the MSRB's proposed requirements in all material respects. FINRA expects that as a result, FINRA and the MSRB will adopt coordinated requirements with a harmonized implementation schedule.

FINRA notes that it solicited comments on these potential requirements in a previously issued Regulatory Notice.[46] FINRA has also reviewed the comments that were submitted on these requirements included in the MSRB Proposal. As FINRA explains in Partial Amendment No. 1, it believes these requirements are appropriate and can be implemented in a way that mitigates the concerns raised by commenters, particularly about the requirement for a link to security-specific TRACE data. Given that FINRA believes that these issues have been raised for comment and it has addressed commenters' concerns in Partial Amendment No. 1, it is proposing to add these requirements to the Proposal by way of amendment, rather than as a separate filing, to satisfy commenters' strong call for harmonization with the MSRB Proposal.

DVP/RVP Accounts

One commenter, Thomson Reuters, asked FINRA to clarify that the Proposal would not require modifications to the DTCC ID system to account for DVP/RVP accounts that might fall within the scope of the proposal because they do not meet the definition of "institutional account." Alternatively, Reuters suggested that FINRA could exempt DVP/RVP accounts from the proposal without compromising the proposal's focus on retail investors.[47]

FINRA continues to believe that mark-up disclosure under the Proposal is appropriate for any account that does not qualify as an institutional account. FINRA also believes that few non-institutional accounts are DVP/RVP accounts. As a result, FINRA does not believe it is appropriate to amend the Proposal to exempt DVP/RVP accounts from its scope. FINRA's belief is informed in part by its understanding that DVP/RVP accounts could receive mark-up disclosure without necessitating changes to the DTCC ID system, whether through free text fields currently available in the system or by other means.

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44 See BDA Letter at 2; SIFMA Letter at 12; Reuters II Letter at 3. The fourth commenter, FIF, raised operational concerns with these requirements that are discussed in detail in Partial Amendment No. 1.

45 See SEC Investor Advocate Memo at 6.

46 See Partial Amendment No. 1 (analyzing feedback received on Regulatory Notice 15-36).

47 See Reuters II Letter at 2.

Consideration of Costs and Alternatives

Two commenters questioned the costs of the Proposal. FIF questioned whether the economic analysis that FINRA included in the Proposal was sufficient, and reiterated its position that the costs of the Proposal will be significant, while the intended benefits of the Proposal are not subject to quantitative measurement.[48] SIFMA stated that the Proposal will confuse investors and impose unjustified costs, and that retail investors would be better served by alternatives the focus exclusively on increasing usage of TRACE.[49] In addition, as a result of firm outreach, FINRA is aware that some members may be concerned about the costs of being questioned by regulators or investors about the adequacy of their procedures to comply with Rule 2121 on a real-time, trade-by-trade basis.

Based on FIF and SIFMA's view of the Proposal's potential costs, they discuss alternatives that they believe would be more efficient. FIF argued that PMP should be determined by reference to some price other than contemporaneous cost, as Rule 2121 currently requires, to lessen the cost of coding systems to identify offsetting trades and to compare their costs.[50] SIFMA stated that retail investors would be better served by alternatives that focus exclusively on increasing usage of TRACE.[51]

FINRA continues to believe that the Proposal is justified. FINRA included significant economic analysis in the Proposal, which was based on a multi-year process during which FINRA published two Regulatory Notices to solicit feedback on the potential impacts of additional pricing disclosure. FINRA understands the cost concerns expressed by commenters and the firms FINRA has spoken with. Further discussion with industry members has reinforced the costs associated with altering the current practice of near straight-through processing of confirmations after a transaction and the potential for regulatory and legal risk associated with mistakes made in determining the PMP for purposes of the Proposal. But FINRA received no additional data about the magnitude of these costs.

The Proposal's economic impact assessment was premised on the adherence to Rule 2121 guidance by members. To the extent that some members are not reasonably following Rule 2121's step-by-step guidance to determine PMP in the manner they would need to under the Proposal, FINRA recognizes that the implementation costs may potentially be substantially higher than for other firms. However, in the absence of any new data on potential costs that FINRA did not already consider in the Proposal, FINRA continues to believe that the Proposal's economic impact assessment is sufficient and appropriate. Moreover, FINRA believes the guidance it has included in this letter may address some of these concerns by reducing the potential costs or burdens of the Proposal.

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48 See FIF Letter at 4.

49 See SIFMA Letter at 1-2.

50 See FIF Letter at 4-6. As noted above, supra note 26, FINRA believes it is unclear exactly how FIF's proposed alternative would differ from the approach set forth in the Proposal.

51 See SIFMA Letter at 1-2.

Implementation Timeline

Five commenters—BDA, Fidelity, Thomson Reuters, SIFMA, and Wells Fargo—requested a longer implementation period. Each of these commenters argued that one year would not allow firms enough time to prepare their systems to comply with the Proposal, particularly given other significant regulatory burdens already slated for implementation in 2017. These commenters suggested a minimum implementation period ranging from eighteen months to three years. FIF suggested a phased approach to implementation that would allow at least a year for firms to develop the ability to determine and capture PMP, and an additional 6-9 months to apply the information to the confirmation process. On the other hand, the SEC Investor Advocate recommended a one-year implementation period, although it recognized that technical and systems changes would be required to comply with the Proposal.[52]

As discussed above, FINRA recognizes the operational challenges associated with the Proposal. Accordingly, in Partial Amendment No. 1, FINRA will extend the time period within which the Proposal would become effective, should it be approved, from one year to eighteen months. FINRA believes this change is an appropriate balance of the commenters' concerns and the strong desire to begin delivering additional pricing information to customers under the Proposal as soon as practicable.

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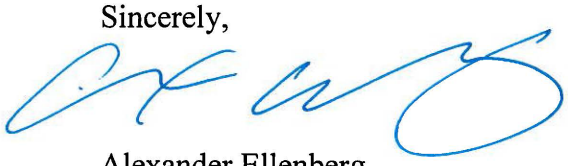
FINRA believes that the foregoing responds to the issues raised by comments on the Proposal. If you have any questions, please contact me at [redacted] or [redacted].

Sincerely,



Alexander Ellenberg
Associate General Counsel

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52 See SEC Investor Advocate Memo at 11.