



8011-01
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-79346; File No. SR-FINRA-2016-032)

November 17, 2016

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, Relating to FINRA Rule 2232 (Customer Confirmations) to Require Members to Disclose Additional Pricing Information on Retail Customer Confirmations Relating to Transactions in Certain Fixed Income Securities

I. Introduction

On August 12, 2016, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission” or “SEC”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend FINRA Rule 2232 to require FINRA members to disclose additional pricing information on retail customer confirmations relating to certain transactions in fixed income securities. The proposed rule change was published for comment in the Federal Register on August 19, 2016.³ The Commission received nine comment letters from eight commenters in response to the proposal.⁴ On September 28, 2016, pursuant to Section 19(b)(2)

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 78573 (Aug. 15, 2016), 81 FR 55500 (Aug. 19, 2016) (“Notice”).

⁴ See Letter from Manisha Kimmel, Chief Regulatory Officer, Wealth Management, Thomson Reuters, to Brent J. Fields, Secretary, Commission (Sept. 19, 2016) (“Thomson Reuters I”); Letter from Mary Lou Von Kaenel, Managing Director, Financial Information Forum, to Robert W. Errett, Deputy Secretary, Commission (Sept. 9, 2016) (“FIF”); Letter from Sean Davy, Managing Director, Capital Markets Division, and Leslie M. Norwood, Managing Director and Associate General Counsel, Municipal Securities Division, SIFMA, to Robert W. Errett, Deputy Secretary, Commission (Sept. 9, 2016) (“SIFMA”); Letter from Norman L. Ashkenas, Chief Compliance Officer, Fidelity Brokerage Services, LLC, and Richard J. O’Brien, Chief Compliance Officer,

of the Act,⁵ the Commission designated a longer period within which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.⁶ The Commission then received a letter from the SEC Office of the Investor Advocate, submitted to the public comment file, recommending approval of the proposed rule change.⁷ On November 14, 2016, FINRA responded to the comments⁸ and filed Amendment No. 1 to the proposal.⁹ The Commission is publishing this notice to solicit comment on Amendment No. 1 to the proposal from interested persons and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

II. Description of the Proposal, as Modified by Amendment No. 1

A. Background

National Financial Services, LLC, to Brent J. Fields, Secretary, Commission (Sept. 9, 2016) (“Fidelity”); Letter from Mike Nicholas, Chief Executive Officer, Bond Dealers of America, to Brent J. Fields, Secretary, Commission (Sept. 9, 2016) (“BDA”); Letter from Robert J. McCarthy, Director of Regulatory Policy, Wells Fargo Advisors, LLC, to Robert W. Errett, Deputy Secretary, Commission (Sept. 9, 2016) (“Wells Fargo”); Letter from Scott A. Eichhorn, Practitioner in Residence and Supervising Attorney, Investor Rights Clinic, University of Miami, et al., to Brent Fields, Secretary, Commission (Sept. 8, 2016) (“UMiami”); Letter from Manisha Kimmel, Chief Regulatory Officer, Wealth Management, Thomson Reuters, to Brent J. Fields, Secretary, Commission (Sept. 8, 2016) (“Thomson Reuters II”); and Letter from Hugh Berkson, President, PIABA, to Robert W. Errett, Deputy Secretary, Commission (Sept. 7, 2016) (“PIABA”).

⁵ See 15 U.S.C. 78s(b)(2).

⁶ See Securities Exchange Act Release No. 34-78965 (Sept. 28, 2016), 81 FR 68492 (Oct. 4, 2016) (FINRA-2016-032).

⁷ See Letter from Rick A. Fleming, Investor Advocate, Office of the Investor Advocate, to Commission (Nov. 7, 2016) (“Investor Advocate”).

⁸ See Letter from Alexander Ellenberg, Associate General Counsel, FINRA, to Brent J. Fields, Secretary, Commission, dated November 14, 2016 (“FINRA Response Letter”).

⁹ Amendment No. 1 is available on the Commission’s website at: <https://www.sec.gov/comments/sr-finra-2016-032/finra2016032-13.pdf>.

FINRA proposes to amend FINRA Rule 2232 (Customer Confirmations) to require a member effecting certain transactions as principal with non-institutional customers in a corporate debt or agency debt security to disclose the member's mark-up/mark-down from the prevailing market price ("PMP") for the security on the customer confirmation.¹⁰ FINRA also proposes to require for all transactions in corporate or agency debt securities with non-institutional customers, irrespective of whether mark-up/mark-down disclosure is required, that the member provide on the confirmation (1) a reference, and hyperlink if the confirmation is electronic, to a webpage hosted by FINRA that contains publicly available trading data from FINRA's Trade Reporting and Compliance Engine ("TRACE") for the specific security that was traded, in a format specified by FINRA, along with a brief description of the type of information available on that page; and (2) the execution time of the customer transaction, expressed to the second.¹¹

FINRA developed the proposal, as modified by Amendment No. 1, in coordination with the Municipal Securities Rulemaking Board ("MSRB") to advance the goal of providing additional pricing information, including transaction cost information, to non-institutional customers in corporate, agency, and municipal debt securities.¹² FINRA and the MSRB have worked toward consistent rule requirements in this area, as appropriate, to minimize the operational burdens for firms that are both FINRA members and MSRB registrants that transact

¹⁰ See Notice, supra note 3. For ease of reference, a "non-institutional customer" is also alternatively referred to as a "retail customer" or "retail investor," which, among others are not included in the definition of an institutional customer.

¹¹ See Amendment No. 1, supra note 9, at 5. FINRA also proposes in Amendment No. 1. to add the term "offsetting" to proposed Rule 2232(c)(2) to conform the rule language to the language used to discuss conditions that trigger the disclosure requirement, and extend the implementation period of the proposal from one year to 18 months.

¹² See, e.g., Notice, supra note 3, at 55500. The proposal, as modified by Amendment No. 1, would apply to corporate and agency debt securities. It would not apply to U.S. Treasury Securities. See proposed Rules 2232(c),(e), and (f); see also note 37 infra.

in multiple types of fixed income securities.¹³ The proposal, as modified by Amendment No. 1, is before the Commission following a process in which FINRA twice solicited comment on related proposals, and subsequently incorporated modifications designed to address commenters' concerns.¹⁴

In November 2014, FINRA, concurrently with the MSRB, published a regulatory notice requesting comment on the Initial Proposal to require disclosure of pricing information for certain same-day, retail-sized principal transactions.¹⁵ In the Initial Proposal, FINRA proposed to require customer confirmation disclosure of additional pricing information when a member executes a sell (buy) transaction of “qualifying size” with a customer and executes a buy (sell) transaction as principal with one or multiple parties in the same security within the same trading day, where the size of the customer transaction(s) would otherwise be satisfied by the size of one or more same-day principal transaction(s). To supplement the price to the customer, which

¹³ The MSRB has filed with the Commission a proposal and amendment that is substantially similar to this proposal, as modified by Amendment No. 1. See Securities Exchange Act Release No. 78777 (Sep. 7, 2016), 81 FR 62947 (Sep. 13, 2016) (SR-MSRB-2016-12) (“MSRB Proposal”); see also MSRB Amendment No. 1, available at: <https://www.sec.gov/comments/sr-msrb-2016-12/msrb201612-11.pdf>.

¹⁴ See FINRA Regulatory Notice 14-52, Pricing Disclosure in the Fixed Income Markets: FINRA Requests Comment on a Proposed Rule Requiring Confirmation Disclosure of Pricing Information in Fixed Income Securities Transactions (Nov. 2014) (the “Initial Proposal”), available at: http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_14-52.pdf. See also FINRA Regulatory Notice 15-36, Pricing Disclosure in the Fixed Income Markets: FINRA Requests Comment on a Revised Proposal Requiring Confirmation Disclosure of Pricing Information in Corporate and Agency Debt Securities Transactions (Oct. 2015) (“Revised Proposal”), available at: http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-15-36.pdf.

¹⁵ The Initial Proposal was published concurrently with a similar proposal by the MSRB. See MSRB Regulatory Notice 2014-20, Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations (Nov. 17, 2014), available at: <http://www.msrb.org/~media/files/regulatory-notices/rfcs/2014-20.ashx>.

currently is required to be provided on customer confirmations, members would additionally have been required to disclose (i) the price to the firm of the same-day trade (“reference price”); and (ii) the difference between those two prices. Designed to capture transactions with retail investors, the term “qualifying size,” was defined to include transactions of 100 bonds or less or bonds with a face value of \$100,000 or less.

As more fully summarized in the Notice, FINRA received a number of comments on the Initial Proposal.¹⁶ Some commenters supported FINRA’s Initial Proposal, stating that the proposed confirmation disclosure would provide additional post-trade information that would be otherwise difficult for a retail investor to ascertain and would foster increased price competition in fixed income markets, which would ultimately lower investors’ transaction costs.¹⁷ Some of these commenters urged FINRA to expand the Initial Proposal so that it would apply to all trades involving retail investors.¹⁸ But many commenters were critical of the Initial Proposal. Some commenters critical of the Initial Proposal believed that the proposed scope was overbroad, that a reference price was not necessarily a useful point of pricing information, and/or that FINRA’s proposed methodologies for calculating the reference price were too complex.¹⁹ In response to the comments received, FINRA made several modifications to the Initial Proposal and solicited comment on a Revised Proposal.²⁰ The modifications reflected in the Revised Proposal were

¹⁶ See Notice, supra note 3, at 55507-55508 (summarizing comments received by FINRA on the Initial Proposal).

¹⁷ See Notice, supra note 3, at 55507.

¹⁸ Id.

¹⁹ See Notice, supra note 3, at 55507-55508.

²⁰ See Revised Proposal, supra note 14.

designed to ensure that the disclosure applied to transactions with retail investors, enhance the utility of the disclosure, and reduce the operational complexity of providing the disclosure.²¹

In response to similar comments received on its initial proposal, the MSRB incorporated several modifications to be consistent with FINRA’s proposal;²² however, the MSRB proposed to depart from the “reference price” approach and instead require that firms disclose the amount of mark-up/mark-down from the PMP for certain retail customer transactions.²³ Specifically, the MSRB proposed to require firms to disclose their mark-up/mark-down on the retail customer’s

²¹ See Notice, supra note 3, at 55508 (explaining FINRA’s modifications to the Initial Proposal in the Revised Proposal). FINRA’s Revised Proposal included the following revisions: (i) replacing the “qualifying size” requirement with an exclusion for transactions with institutional accounts, as defined in FINRA Rule 4512(c); (ii) excluding transactions which are part of fixed-price offerings on the first trading day and which are sold at the fixed-price offering price; (iii) excluding firm-side transactions that are conducted by a department or trading desk that is functionally separate from the retail-side trading desk; (iv) excluding trades where the member’s principal trade was executed with an affiliate of the member and the affiliate’s position that satisfied this trade was not acquired on the same trading day; (v) requiring members to provide a hyperlink to publicly available corporate and agency debt security trade data disseminated from TRACE on the customer confirmation; (vi) permitting members to omit the reference price in the event of a material change in the price of the security between the time of the member’s principal trade and the customer trade; and (vii) permitting members to use alternative methodologies to determine the reference price in complex trade scenarios, provided the methodologies were adequately documented, and consistently applied. See Revised Proposal, supra note 14.

²² See 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 (Sept. 24, 2015), available at: <http://www.msrb.org/~media/files/regulatory-notice/rfcs/2015-16.ashx>. In its revised proposal, the MSRB, consistently with FINRA, proposed that certain categories of transactions be excluded from the disclosure requirement, including (i) transactions with institutional accounts; (ii) firm-side transactions if conducted by a “functionally separate principal trading desk” that had no knowledge of the non-institutional customer transaction; and (iii) customer transactions at list offering prices. For trades with an affiliate of the firm, the MSRB also proposed to “look through” the firm’s trade with the affiliate to the affiliate’s trade with the third party for purposes of determining whether disclosure would be required.

²³ See id.

trade if the firm bought (sold) the security in one or more transactions in an aggregate trade size that met or exceeded the size of the sale (purchase) to (from) the non-institutional customer within two hours of the customer transaction.²⁴ The disclosed mark-up/mark-down would have been required to be expressed both as a total dollar amount and as a percentage of the PMP.²⁵ Additionally, the MSRB proposed to require the disclosure of two additional data points on all customer confirmations, even those for which mark-up/mark-down disclosure was not required: a security-specific hyperlink to the publicly available municipal security trade data on the MSRB's Electronic Municipal Market Access ("EMMA") website, and the time of execution of a customer's trade.²⁶

Although FINRA and the MSRB took different approaches in their revised proposals – diverging primarily on the questions of whether to require disclosure of reference price or mark-up/mark-down, and whether to specify a same-day or two-hour time frame – each acknowledged the importance of achieving a consistent approach and invited comments on the relative merits and shortcomings of both approaches.²⁷ Following a second round of comments, publication of a third related proposal by the MSRB,²⁸ as well as investor testing conducted jointly by FINRA and the MSRB in mid-2016,²⁹ FINRA and the MSRB made a third round of revisions to achieve a consistent approach and filed the proposed rule changes, each as modified by Amendment No.1, that are before the Commission.

²⁴ See id.

²⁵ See id.

²⁶ See id.

²⁷ See Revised Proposal, supra note 14; MSRB Regulatory Notice 2015-16, supra note 22.

²⁸ See MSRB Regulatory Notice 2016-07, Request for Comment on Draft Amendments to MSRB Rule G-30 to Provide Guidance on Prevailing Market Price (Feb. 18, 2016), available at: <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2016-07.ashx>.

B. Proposed Amendments to FINRA Rule 2232

1. Overview

FINRA proposes to amend FINRA Rule 2232 (Customer Confirmations) to add new paragraphs (c) – (f). Proposed Rule 2232(c) would require that a customer confirmation for a transaction in a corporate or agency debt security include the member’s mark-up/mark-down for the transaction, to be calculated in compliance with FINRA Rule 2121, expressed as a total dollar amount and as a percentage of the PMP if (1) the member effects a transaction in a principal capacity with a non-institutional customer and (2) the member purchased (sold) the security in one or more offsetting transactions in an aggregate trading size meeting or exceeding the size of such sale to (purchase from) the non-institutional customer. Proposed Rule 2232(c) also would address how a member’s transactions with affiliates are to be considered. Proposed Rule 2232(d) would specify limited exceptions.³⁰

Proposed Rule 2232(e), which is the subject of Amendment No. 1, additionally would require that for all transactions in corporate or agency debt securities with non-institutional customers, irrespective of whether mark-up/mark-down disclosure is required, the member provide on the confirmation (i) a reference, and hyperlink if the confirmation is electronic, to a web page hosted by FINRA that contains TRACE publicly available trading data for the specific security that was traded, in a format specified by FINRA, along with a brief description of the type of information available on that page; and (ii) the execution time of the customer transaction, expressed to the second.³¹

²⁹ See Notice, supra note 3 at 55502 n.14, 55503, 55504, referencing investor testing.

³⁰ See proposed Rule 2232(d), regarding functionally separate trading desks and certain transactions in new issues.

³¹ See Amendment No. 1, supra note 9, at 5.

Proposed Rule 2232(f) would set forth defined terms.³²

In addition, FINRA Rule 0150 would be amended to make the proposed rule change, as modified by Amendment No. 1, applicable to agency debt securities, but not to U.S. Treasury Securities.³³

2. Scope of the Mark-up/Mark-down Disclosure Requirement

Under proposed Rule 2232(c), mark-up/mark-down disclosure would be required if: (1) the member is effecting a transaction in a principal capacity in a corporate or agency debt security with a non-institutional customer, and (2) the member purchased (sold) the security in one or more offsetting transactions in an aggregate trading size meeting or exceeding the size of such sale to (purchase from) the non-institutional customer on the same trading day as the non-institutional customer transaction.³⁴

A non-institutional customer is a customer that does not have an institutional account, as defined in FINRA Rule 4512(c).³⁵ In addition, the proposal, as modified by Amendment No. 1,

³² See proposed Rule 2232(f).

³³ See note 12 *supra*; note 36 *infra*.

³⁴ See Notice, *supra* note 3, at 55500. See also Amendment No. 1, *supra* note 9, at 4, in which FINRA further clarifies that disclosure obligations are triggered by “offsetting” transactions, and not only by “matched” trades.

³⁵ See proposed Rule 2232(f)(4). See also FINRA Rule 4512(c), defining an institutional account as: an account of “(1) a bank, savings and loan association, insurance company or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million. FINRA states that use of this definition to define the scope of the proposal is appropriate because firms use this definition in other rule contexts and it will therefore reduce the implementation costs of the proposal. See Notice, *supra* note 3 at 55501.

would apply only to transactions in corporate debt securities, as defined in the proposed rule,³⁶ and agency debt securities, as defined in FINRA Rule 6710(l).³⁷

Discussing the rationale for the mark-up/mark-down disclosure requirement generally, FINRA notes that while members already are required, pursuant to Securities Exchange Act Rule 10b-10 (“Rule 10b-10”), to provide pricing information on customer confirmations, including transaction cost information, for transactions in equity securities where the member acted as principal, no comparable requirement currently exists for transactions in fixed-income securities.³⁸ Discussing the same-day offsetting trade trigger for mark-up/mark-down disclosure more specifically, FINRA states that it believes that a full-day window (as compared to a shorter window such as two-hours) will ensure that more non-institutional investors receive the benefit of mark-up/mark-down disclosure;³⁹ and adds that limiting the required disclosure to those instances where there is an offsetting trade in the same trading day will reduce the variability of

³⁶ The rule would define a corporate debt security as a “debt security that is United States (“U.S.”) dollar-denominated and issued by a U.S. or foreign private issuer and, if a ‘restricted security’ as defined in Securities Act Rule 144(a)(3), sold pursuant to Securities Act Rule 144A, but does not include a Money Market Instrument as defined in FINRA Rule 6710(o) or an Asset-Backed Security as defined in FINRA Rule 6710(cc).” See Proposed Rule 2232(f).

³⁷ Existing FINRA Rule 6710(l) defines an agency debt security as “a debt security (i) issued or guaranteed by an Agency as defined in paragraph (k); or (ii) issued or guaranteed by a Government-Sponsored Enterprise as defined in paragraph (n). The term excludes a U.S. Treasury Security as defined in paragraph (p) and a Securitized Product as defined in paragraph (m), where an Agency or a Government-Sponsored Enterprise is the Securitizer as defined in paragraph (s) (or similar person), or the guarantor of the Securitized Product.” See Notice, supra note 3, at 55501 n. 9

³⁸ See Notice, supra note 3, at 55000 n.3.

³⁹ See Notice, supra note 3, at 55501 and 55509 (discussing data evidencing dispersion in mark-ups/mark-downs in firm principal/customer trades in corporate and agency debt securities).

the mark-up/mark-down calculation.⁴⁰ FINRA also emphasizes that a full-day window may make members less likely to alter their trading patterns to avoid the rule, as members would be required to hold positions overnight to avoid the customer confirmation disclosure requirement which action may be in contravention of a member's other obligations under FINRA rules.⁴¹

For purposes of determining whether the mark-up/mark-down disclosure requirement would be triggered, proposed Rule 2232(c) also addresses how a member's transactions with affiliates are to be considered. If a member executes an offsetting principal trade(s) with an affiliate, the rule would require a member to determine whether the transaction was an "arms-length transaction."⁴² The rule defines an arms-length transaction as "a transaction that was conducted through a competitive process in which non-affiliate firms could also participate, and where the affiliate relationship did not influence the price paid or proceeds received by the member."⁴³ If the transaction is not an arms-length-transaction, the rule would require the member to "look through" to the time and terms of the affiliate's separate purchase (sale) of the security with a third party to determine whether the confirmation disclosure requirement is

⁴⁰ See Notice, supra note 3, at 55501.

⁴¹ See Notice, supra note 3, at 55501 n.11, in which FINRA notes that under FINRA Rule 5310 (Best Execution and Interpositioning) members are required to use reasonable diligence to ascertain the best market for the security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions, and that under Supplementary Material .01 to FINRA Rule 5310 a member must make every effort to execute a marketable customer order that it receives fully and promptly. FINRA states that a firm found to purposefully delay the execution of a customer order to avoid the proposed disclosure may be in violation of the proposed rule, FINRA Rule 5310 and FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade).

⁴² See Notice, supra note 3, at 55501.

⁴³ As a general matter, FINRA would expect that the competitive process used in an "arms-length" transaction, e.g., the request for pricing or platform for posting bids and offers, is one in which non-affiliates have frequently participated. See Notice, supra note 3, at 55501-2.

applicable.⁴⁴ FINRA states that sourcing liquidity through a non-arms-length transaction with an affiliate is functionally equivalent to selling out of its own inventory, and therefore that it is appropriate in the case of a non-arm's length transaction to require a member to "look through" to the affiliate's transaction with a third party to determine whether the disclosure requirement is triggered.⁴⁵

The proposed rule also specifies two exceptions from the disclosure requirement. First, if the member's offsetting same-day firm principal trade was executed by a trading desk that is functionally separate from the member's trading desk that executed the transaction with the non-institutional customer, the principal trade by that separate trading desk would not trigger the confirmation disclosure requirement.⁴⁶ To avail itself of this exception, a member must have in place policies and procedures reasonably designed to ensure that the functionally separate principal trading desk through which the member purchase or sale was executed had no knowledge of the customer transaction.⁴⁷ For example, in the case of a purchase/sale transaction with a non-institutional customer effected by the retail trading desk, if a functionally separate institutional trading desk within the same member firm effected a purchase/sale in the same security to service an institutional customer, that trade would not trigger the disclosure

⁴⁴ See Notice, supra note 3, at 55502 n.12. FINRA adds that, in a non-arms-length transaction with an affiliate, the member also would be required to "look-through" to the affiliate's transaction with a third party and related cost or proceeds by the affiliate as the basis for determining the member's calculation of the mark-up/mark-down pursuant to FINRA Rule 2121 (Fair Prices and Commissions) See id.

⁴⁵ See Notice, supra note 3, at 55502.

⁴⁶ See Proposed Rule 2232(d)(1).

⁴⁷ See id. In the Notice, FINRA notes that the separate trading desk exception would only determine whether or not the proposed disclosure requirement has been triggered and would not change a member's existing requirements relating to the calculation of its mark-up/mark-down under FINRA Rule 2121. See Notice, supra note 3, at 55502 n.13.

requirement, provided that the institutional trading desk was operated pursuant to policies and procedures reasonably designed to ensure that institutional desk through which the member purchase or member sale was executed had no knowledge of the non-institutional customer transaction.⁴⁸ In addition, the rule does not apply if the member acquired the security in a fixed-price offering and sold the security to non-institutional customer(s) at the fixed-price offering price on the day the securities were acquired.⁴⁹

3. Information to be Disclosed and/or Provided

a. Mark-up/Mark-down

Rule 2232(c) would require that the member's mark-up/mark-down for the transaction be calculated in compliance with FINRA Rule 2121 and expressed as a total dollar amount and as a percentage of the PMP.⁵⁰ FINRA represents that its determination to require disclosure of both the total dollar amount and the percentage of the PMP is supported by investor testing, which found disclosure of this information in both forms would be more useful than disclosure of the information in only one of these forms.⁵¹ FINRA also explains that members currently are already subject to FINRA Rule 2121, including Supplementary Material .02 to FINRA Rule 2121, which provides extensive guidance on how to determine the PMP and calculate mark-ups/mark-downs for the fixed-income securities to which the proposal would apply, including a presumption to use contemporaneous cost or proceeds.⁵² FINRA recognizes that the

⁴⁸ FINRA further explains that a firm could not use the functionally separate trading desk exception to avoid the proposed disclosure requirement if the institutional desk was used to source securities by the retail desk. See Notice, supra note 3, at 55502.

⁴⁹ See Proposed Rule 2232(d)(2).

⁵⁰ See Proposed Rule 2232(c).

⁵¹ See Notice, supra note 3, at 55502 n.14.

⁵² See Notice, supra note 3, at 55502.

determination of the PMP of a particular security may not be identical across member firms.⁵³ FINRA states that members would be expected to have reasonable policies and procedures in place to determine the PMP in a manner consistent with FINRA Rule 2121, and that such policies and procedures be applied consistently across customers.⁵⁴ Regarding when a mark-up/mark-down is to be calculated and disclosed, FINRA notes that the mark-up on a customer trade should “generally be established at the time of that trade” and states that members may generate customer confirmations that include a mark-up/mark-down disclosure on an intra-day basis.⁵⁵

b. Reference/HyperLink to TRACE and Execution Time of Trade

FINRA initially represented that it would submit a separate filing proposing that confirmations include a hyperlink to publicly available TRACE data and the execution time of the customer trade.⁵⁶ FINRA stated that comments received on the Revised Proposal and the results of investor testing justified the addition of these requirements.⁵⁷ In response to comments urging FINRA and the MSRB to harmonize both the substance and the time frames of their proposals, FINRA proposes in Amendment No. 1 to include these requirements in the same manner and form as the MSRB has proposed.⁵⁸ Specifically, proposed Rule 2232(e) would require that for all transactions in corporate or agency debt securities with non-institutional

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Id.

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Id.

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See Notice supra note 3, at 55506. See also notes 128-130, infra, and accompanying text (discussing FINRA’s response to commenters concerned about the proposal’s potential to disrupt the intra-day confirmation generation process).

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See Notice, supra note 3, at 55502 n.14.

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Id.

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See Amendment No. 1, supra note 9, at 4. See also MSRB Proposal, supra note 13, at 62950-62951; MSRB Amendment No. 1, supra note 13, at 4-5.

customers, the member provide on the confirmation (1) a reference, and hyperlink if the confirmation is electronic, to a webpage hosted by FINRA that contains TRACE publicly available trading data for the specific security that was traded, in a format specified by FINRA, along with a brief description of the type of information available on that page; and (2) the execution time of the customer transaction, expressed to the second.⁵⁹ Amendment No. 1, in which FINRA proposes to require inclusion of these additional data points, is more fully discussed below.

C. Effective Date of the Proposed Rule Change

FINRA represents that it will announce the effective date of the proposed rule change and the specific implementation date in a Regulatory Notice to be published no later than 90 days following Commission approval of the proposal. FINRA initially proposed that the effective date would be no later than 12 months following Commission approval of the proposal. In Amendment No. 1, FINRA proposes to extend the effective date to 18 months following Commission approval of the proposal.⁶⁰

III. Summary of Comments and FINRA Response Letter, Investor Advocate Recommendation, Amendment No. 1

The Commission received nine comment letters from eight commenters, regarding the proposed rule change, and a letter from the Investor Advocate recommending approval of the proposed rule change.⁶¹ Many of the commenters expressed support for the goals of the

⁵⁹ See Amendment No. 1, supra note 9, at 5; proposed Rule 2232(e).

⁶⁰ See Notice, supra note 3, at 55503; Amendment No. 1, supra note 9, at 12.

⁶¹ See supra notes 4 and 7. The views of the Investor Advocate are noted in the context of specific issues raised by commenters, as well as separately.

proposal.⁶² Many commenters, however, expressed some concern about implementing the proposal and requested guidance or certain changes to the proposal to facilitate and reduce the costs of implementation.⁶³ Areas of concern included: (1) the scope of the proposal; (2) methodology and timing for calculating the PMP; (3) acceptable ways to present mark-up/mark-down disclosure information on the customer confirmation; (4) areas of inconsistency with MSRB Proposal; and (5) the effective date of the proposed rule change due to its anticipated costs.

A. Scope of the Proposal

Several commenters addressed the same-day offsetting trade aspect of the proposal's scope. One commenter stated that the same-day window was too limited.⁶⁴ Some commenters expressed concern about the operational impact of the same-day window. Specifically, two commenters were concerned that the same-day nature of the proposal would require a member to

⁶² See PIABA, at 1 (stating that increased transparency on customer confirmation is a necessary step); Wells Fargo, at 3 (supporting FINRA's efforts to improve price transparency in fixed income markets); Fidelity, at 2 (noting Fidelity's appreciation of regulatory efforts to improve price transparency in the fixed income markets); BDA, at 1 (accepting that retail investors could benefit from disclosure of mark-up (mark-down) on same-day trades); SIFMA, at 1 (expressing support for FINRA's objective to enhance fixed income price transparency for retail investors). See also UMiami, at 1-3 (more generally expressing support for the proposal). See also Investor Advocate, *supra* note 7, at 2 (recommending that the Commission approve the proposal).

⁶³ See generally SIFMA; BDA, Thomson Reuters II; Wells Fargo; Fidelity; FIF. Among these commenters SIFMA and Wells Fargo suggested that FINRA instead pursue a proposal focusing exclusively on providing information about prevailing market conditions through TRACE. See SIFMA, at 2; Wells Fargo, at 2.

⁶⁴ See PIABA, at 1-2. This commenter encouraged FINRA to emphasize that "[a]ny intentional delay of a customer execution to avoid the proposed rule . . . would be contrary to [Best Execution] duties to customers." But see Investor Advocate, *supra* note 7, at 7 (stating that a same-day window of time for disclosure was appropriate and that a full-day window would deter members from adjusting their behavior to avoid the disclosure requirements.)

look forward to transactions occurring after the execution of the non-institutional trade to determine whether that trade requires mark-up/mark-down disclosure, and that this would disrupt the confirmation process.⁶⁵ One of these commenters urged FINRA to eliminate the “look-forward requirement” so that members could determine the need for disclosure at the time of trade.⁶⁶ Another commenter advocated eliminating not only the look-forward aspect of the proposal, but also the look-back aspect.⁶⁷ According to this commenter, mark-up/mark-down disclosure should be provided for all retail customer transactions.⁶⁸

In response, FINRA stated that it “continues to believe that a same-day timeframe is an appropriate trigger for disclosure.”⁶⁹ FINRA acknowledged that members could incur costs to identify customer trades subject to the proposal’s disclosure requirements.⁷⁰ However, FINRA indicated that members could avoid the cost associated with the look-forward aspect of the rule by choosing to “provide mark-up disclosure more broadly if they find it beneficial to do so.”⁷¹

⁶⁵ See Thomson Reuters II, at 3; FIF, at 2, 4-5.

⁶⁶ See Thomson Reuters II, at 3. This commenter also noted that members choosing to provide mark-up/mark-down disclosure on all confirmations in order to ease implementation of the rule might hesitate to do so unless they could provide additional text on customer confirmations to put the mark-up/mark-down disclosure “in context.” Id.

⁶⁷ See FIF, at 2, 4-5. FIF suggested that the “trigger” be eliminated from the rule to avoid members having to wait to determine if a trigger trade occurred later in the day (look-forward) or to assess whether a trigger trade existed at the end of the day (look-back). Id.

⁶⁸ See id.

⁶⁹ See FINRA Response Letter, at 3.

⁷⁰ See FINRA Response Letter, at 4.

⁷¹ See FINRA Response Letter, at 4-5.

FINRA also noted that members' best execution obligations and surveillance by FINRA should deter inappropriate gaming of the same-day trigger.⁷²

One commenter requested clarification on FINRA's statement in the Notice that disclosure is triggered when a member executes one or more offsetting principal transaction(s) on the same trading day. This commenter asked whether the confirmation disclosure requirement is triggered only when a customer trade has an offsetting principal trade or if a firm must continue to disclose its mark-up/mark-down until the triggering trade has been exhausted, at which point the firm may choose to continue to disclose or not.⁷³

FINRA responded that there must be offsetting customer and firm principal trades for the disclosure requirement to be triggered, and explained that if a member purchased 100 bonds at 9:30 AM, and then satisfied 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 have been satisfied by selling out of the member's inventory rather than through an offsetting principal transaction by the member.⁷⁴ In addition, FINRA noted that, in Amendment No. 1, it was proposing to provide added clarity on this point by adding the term "offsetting" to Rule 2232(c)(2) to conform the rule language to the language used to discuss conditions that trigger the disclosure requirement.⁷⁵

FINRA further explained that the proposal applies to "offsetting" transactions, and is not limited

⁷² See FINRA Response Letter, at 3.

⁷³ See SIFMA, at 8.

⁷⁴ See FINRA Response Letter, at 4-5.

⁷⁵ See FINRA Response Letter, at 4 n.16.

to “matched” trades.⁷⁶ FINRA also noted in its response to comments that a member could “develop reasonable policies and procedures to identify and account for offsetting trades that trigger the [p]roposal, provided the member applies those policies and procedures in a consistent manner.”⁷⁷

One commenter questioned how the proposal would apply to certain small institutions that may fall into FINRA’s definition of “non-institutional customer,” but trade via accounts that settle on a delivery versus payment/receive versus payment (DVP/RVP) basis and rely on confirmations generated through the Depository Trust and Clearing Corporation’s institutional delivery (DTCC ID) system.⁷⁸ Because it is possible for those firms to receive confirms through the DTCC ID process, the commenter asked FINRA to clarify whether its proposal requires modifications to the DTCC ID system.⁷⁹

FINRA responded that it believes that few non-institutional accounts settle on a DVP/RVP basis and that it would not be appropriate to exempt such accounts from the scope of the proposal.⁸⁰ FINRA noted that non-institutional accounts that settle on a DVP/RVP basis using the services of the DTCC ID system “could receive mark-up disclosure without necessitating changes to the DTCC ID system, whether through free text fields currently in the system or by other means.”⁸¹ Accordingly, FINRA stated that it continues to believe that mark-

⁷⁶ See id. See also Amendment No. 1, supra note 9, at 4; MSRB Amendment No. 1, supra note 13, at 4 n.6.

⁷⁷ See FINRA Response Letter, at 5.

⁷⁸ See Thomson Reuters II, at 2.

⁷⁹ See id.

⁸⁰ See FINRA Response Letter, at 11.

⁸¹ See id.

up/mark-down disclosure “is appropriate for any account that does not qualify as an institutional account.”⁸²

Another commenter questioned whether FINRA planned to broaden the scope of the rule to cover financial products other than corporate debt and agency securities, asking if the rule would be expanded to include other financial products like TRACE eligible mortgage backed securities, TBAs, asset backed securities or Treasuries.⁸³

One commenter addressed the exception for trades executed by a functionally separate trading desk. That commenter seemed to conflate this exception with a separate provision in the proposed rule change that would require a firm to “look through” a non-arms-length transaction with its affiliate to determine whether the proposed disclosure obligations are applicable.⁸⁴ Specifically, the commenter characterized the functionally separate trading desk exception, as an exception to the “look through” requirement.⁸⁵

In response, FINRA clarified that the look-through provision and functionally separate desk exception are separate provisions of the proposal, intended to operate independently of each other.⁸⁶ FINRA noted that 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.⁸⁷

⁸² See id.

⁸³ See FIF, at 8. FINRA did not respond directly to this comment. However, the Commission notes that FINRA’s rationale for the proposal is based in part on the data it has analyzed for TRACE and that this comment is beyond the scope of FINRA’s present proposal, which applies to transactions in corporate or agency debt securities See Notice, supra, at note 3, at 55503-55507.

⁸⁴ See FIF, at 5 n.8.

⁸⁵ See FIF, at 5 n.8.

⁸⁶ See FINRA Response Letter, at 3 n.11.

⁸⁷ Id.

B. Mark-up/Mark-down Disclosure

1. Determination of PMP and Mark-up/Mark-down in Accordance with FINRA Rule 2121

The Investor Advocate supported the mark-up/mark-down disclosure requirement, stating that this approach has advantages over the reference price approach FINRA contemplated in the Initial Proposal and the Revised Proposal because the mark-up/mark-down approach “provides retail investors with the relevant information about the actual compensation the retail investor is paying the dealer for the transaction . . . [and] reflects market conditions and has the potential to provide a more accurate benchmark for calculating transaction costs.”⁸⁸ Another commenter did not believe that a mark-up/mark-down disclosure requirement was better than the approach contemplated in the Initial Proposal and the Revised Proposal.⁸⁹

Other commenters expressed concern about the need to determine PMP in accordance with FINRA Rule 2121, believing that this requirement would be operationally burdensome.⁹⁰ These commenters requested that FINRA provide additional guidance on how members may determine PMP and calculate mark-ups/mark-downs to facilitate compliance with the rule.⁹¹ Specifically, these two commenters believed that members would need to automate the determination of PMP in order to consistently produce accurate values in the limited time afforded.⁹² One commenter believed that it would be “simply unworkable” to automate the guidance set forth in FINRA Rule 2121 in a manner that would allow members to calculate and

⁸⁸ See Investor Advocate, supra note 7, at 7-8; see also Section III.F. infra.

⁸⁹ See PIABA, at 2.

⁹⁰ See, e.g., BDA, at 3-4; SIFMA, at 5-7.

⁹¹ See id.

⁹² See id.

disclose mark-ups/mark-downs on a systematic basis.⁹³ The other commenter stated that FINRA Rule 2121 would not be easy to convert to the automated operational framework that would be required to comply with the proposed rule change.⁹⁴ Both commenters particularly emphasized that it would be difficult to automate factors in the waterfall that require a subjective analysis of facts and circumstances.⁹⁵ One of these commenters further questioned whether these challenges could result in the disclosure of inaccurate information on customer confirmations.⁹⁶

In addition, one commenter requested explicit guidance from FINRA that the use of “reasonable policies and procedures” would permit member firms to use “alternative methodologies” to determine PMP in an automated manner.⁹⁷ This commenter, SIFMA, particularly requested that members be permitted to make reasonable assumptions in calculating PMP “that do not follow the prescriptive waterfall.”⁹⁸ SIFMA suggested that FINRA “clarify” that reasonable policies for automated calculation of PMP may include pulling prices from: third-party pricing vendors, the firm’s trading book or inventory market-to-market and contemporaneous trades, or “some variation thereof.”⁹⁹ SIFMA also requested that it be deemed

⁹³ See SIFMA, at 5-7.

⁹⁴ See BDA, at 3-4.

⁹⁵ See BDA, at 3-4 (identifying the portion of FINRA Rule 2121 that directs firms to consider “similar securities”); SIFMA at 6-7 (identifying the portion of FINRA Rule 2121 that directs firms to consider whether “news was issued . . . that had an effect on the perceived value of the debt security”).

⁹⁶ See BDA, at 4.

⁹⁷ See SIFMA, at 5-7.

⁹⁸ See SIFMA, at 7.

⁹⁹ See SIFMA, at 6.

reasonable for FINRA members to choose to calculate PMP based solely on the contemporaneous cost of the offsetting transaction, without further automating the waterfall.¹⁰⁰

In addition, SIFMA suggested that FINRA clarify that members may adjust their PMP determination to account for certain characteristics that may affect pricing, such as “the discount or premium inherent in pricing small or institutional-size transactions,” the “difference between inter-dealer and customer markets,” the size of a transaction, and the “side of the market.”¹⁰¹

SIFMA further requested that FINRA provide specific examples demonstrating how to calculate PMP in order to aid the development of reasonable policies, procedures, and methodologies.¹⁰²

In response to comments, FINRA stated that it continues to believe that mark-up/mark-down disclosure should be based on FINRA Rule 2121 guidance.¹⁰³ FINRA noted that members have been subject to FINRA Rule 2121 for ten years, and that it has provided a consistent, prescriptive framework for PMP determination.¹⁰⁴ FINRA believes that the continued use of FINRA Rule 2121 will foster more comparable mark-up/mark-down disclosures across firms.¹⁰⁵ FINRA emphasized that it expects a very significant percentage of the trades that require mark-up/mark-down disclosure to have relatively close-in-time offsetting principal trades, which

¹⁰⁰ Id.

¹⁰¹ See SIFMA, at 9.

¹⁰² See SIFMA, at 10.

¹⁰³ See FINRA Response Letter, at 7.

¹⁰⁴ See FINRA Response Letter, at 7-8. FINRA noted that BDA, while commenting on the potential complexity of automating FINRA Rule 2121 guidance, nevertheless acknowledged that the principles and processes that guide fair pricing assessments—*i.e.*, FINRA Rule 2121—are an appropriate guide for the confirmation disclosure process. Id. See also Investor Advocate, *supra* note 7, at 8 (opining that a PMP-based approach provides retail investors with relevant information that reflects market conditions and potentially a more accurate benchmark for calculating transaction costs than a “reference price” approach).

¹⁰⁵ See FINRA Response Letter, at 8.

would presumptively establish PMP under the first step of FINRA Rule 2121.02 and, therefore, FINRA did not believe that the proposal's reliance on FINRA Rule 2121 would present logistical operational challenges to the degree argued by commenters.¹⁰⁶

FINRA also addressed commenters' requests for additional guidance on establishing reasonable policies and procedures to comply with FINRA Rule 2121.02. FINRA indicated that it did not believe a member's PMP determination under FINRA Rule 2121 must be fully and strictly automated.¹⁰⁷ FINRA nevertheless stated that members may rely on reasonable policies and procedures to facilitate automated PMP determination, provided these policies and procedures are consistent with FINRA Rule 2121.¹⁰⁸ Explaining how the use of reasonable policies and procedures would be consistent with FINRA Rule 2121, FINRA stated that members could, for example, make reasonable judgments about how they apply FINRA Rule 2121. For example, members could calculate contemporaneous costs (proceeds) at the preliminary stage of the FINRA Rule 2121 analysis in cases where the member has multiple principal trades that offset one or more customer trades subject to disclosure.¹⁰⁹ Members also could establish a methodology to adjust contemporaneous costs and proceeds in cases where the member's offsetting trades that trigger disclosure under the proposal are both customer transactions, to avoid "double counting" in the mark-up and mark-down it disclosed to each customer.¹¹⁰ FINRA did not believe, however, that additional adjustments to contemporaneous

¹⁰⁶ See FINRA Response Letter, at 7-8.

¹⁰⁷ See FINRA Response Letter, at 8 n.32.

¹⁰⁸ See FINRA Response Letter, at 8.

¹⁰⁹ See id. FINRA noted, citing the Revised Proposal, that it previously provided detailed guidance to illustrate the average weighted price or last price methodologies that might be appropriate in this scenario. See id.

¹¹⁰ See id.

cost calculations, such as adjustments to reflect the size or side of a contemporaneous trade, as SIFMA requested, are consistent with FINRA Rule 2121.¹¹¹ Providing further examples, FINRA noted that members could develop policies and procedures to address subsequent steps of the FINRA Rule 2121 guidance.¹¹² FINRA believes that certain judgments could be documented up front with the requisite assumptions explained in a member’s procedures, including decisions regarding whether a transaction is “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.¹¹³ FINRA acknowledged 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,”¹¹⁴ but believes, based on outreach to firms and its own experience with market data, that there are ways for members to represent subjective judgments with objective logic that could be documented and applied consistently through reasonable policies and procedures.¹¹⁵ In particular, FINRA stated that it 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.¹¹⁶ Although current systems may not evaluate pricing information exactly as set out in FINRA Rule 2121, FINRA noted that the existence of such

¹¹¹ See id.

¹¹² See id.

¹¹³ See FINRA Response Letter, at 8-9.

¹¹⁴ See FINRA Response Letter, at 9.

¹¹⁵ See id.

¹¹⁶ See id.

systems illustrates the possibility for programming the kinds of decision-making required by FINRA Rule 2121.¹¹⁷ FINRA therefore believes that FINRA Rule 2121 is subject to automation without the need for the “artificial intelligence” that SIFMA suggested would be required.¹¹⁸

Further, in response to comments suggesting that members be permitted to use third-party pricing services, FINRA stated that, under the proposal, members would not be prohibited from engaging third-party service providers to document and perform the steps of the FINRA Rule 2121 analysis, particularly those that look beyond a firm’s own transaction history to more broadly available information.¹¹⁹ FINRA added, however, that members employing such services would retain compliance responsibility, and it would be incumbent on them to perform the due diligence necessary to ensure that third-party service providers were providing them with calculations performed consistently with FINRA Rule 2121.¹²⁰ FINRA cautioned that members would be expected to perform regular reviews of their policies and procedures for mark-up/mark-down 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.¹²¹

Recognizing that members may have more detailed, specific implementation questions FINRA represented that it would work closely with the industry and the MSRB during the implementation period to issue further guidance as necessary.¹²²

¹¹⁷ See id.

¹¹⁸ See id.

¹¹⁹ See id.

¹²⁰ See id.

¹²¹ See id.

¹²² See id.

2. Time of PMP Determination and Mark-up/Mark-down Disclosure

Commenters also addressed the time at which PMP must be determined and the mark-up/mark-down must be calculated and disclosed. Although some commenters believed that the Notice was clear that the proposal permitted members to determine PMP at the time of the customer trade to avoid delay in the confirmation process,¹²³ others sought confirmation and requested additional detail on the determination of PMP at the time of the customer trade.¹²⁴ Specifically, one commenter believed that FINRA had made clear that the PMP determination for calculating a mark-up could be done at the time of trade, but sought confirmation from FINRA that this would also be so for purposes of calculating a mark-down.¹²⁵ Another commenter asked FINRA to acknowledge that changes to the price to the customer would not necessitate changes to the PMP from which the disclosure was calculated and also that members need not resend a corrected confirmation based solely on the occurrence of a subsequent transaction or events that might otherwise be relevant.¹²⁶ This commenter also requested that FINRA provide assurance that an automated calculation of PMP for the purpose of mark-up/mark-down disclosure, based only on the information available at the time of the trade, would not be deemed incorrect by regulators for the purposes of a fair pricing determination.¹²⁷

As noted above, with regard to timing questions, FINRA responded that members may maintain real-time, intra-day confirmation generation processes, stating that “members may determine PMP, as a final matter for disclosure purposes, based on the information the member

¹²³ See Thomson Reuters II, at 2; Fidelity, at 4.

¹²⁴ See Wells Fargo, at 3-4; SIFMA, at 8.

¹²⁵ See Wells Fargo, at 3-4.

¹²⁶ See SIFMA, at 8.

¹²⁷ See SIFMA, at 7.

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,”¹²⁸ which is generally at the time of the trade.¹²⁹ FINRA also confirmed that it 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 calculation under FINRA Rule 2121.02.¹³⁰ FINRA added that, notwithstanding this guidance, it did not believe it was necessary to make a formal distinction between PMP determination for disclosure purposes as opposed to other regulatory purposes, as requested by SIFMA.¹³¹

C. Presentation of Mark-up/Mark-down Information on Customer Confirmations

FINRA proposes to require that mark-ups/mark-downs 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). Several commenters noted that the new disclosures required by the proposal might cause investor confusion, as different members may determine the PMP for the same security differently, resulting in a lack of comparability or consistency across customer confirmations.¹³² One commenter encouraged FINRA to address this issue by monitoring and reviewing relevant

¹²⁸ See FINRA Response Letter, at 6. FINRA adds that it will conduct surveillance to protect against potential gaming of this guidance, as it will with other elements of the proposal. FINRA further states that it 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 calculations. See FINRA Response Letter at 6 n.21.

¹²⁹ See supra note 55 and accompanying text.

¹³⁰ See id.

¹³¹ See FINRA Response Letter, at 6 n.22.

¹³² See Wells Fargo, at 4; SIFMA, at 3; Fidelity, at 3; PIABA, at 2. See also Notice, supra note 3, at 55506.

policies and procedures.¹³³ Other commenters sought clarity on members' ability to provide various explanatory statements or qualifying language on the confirmation. Two commenters, for instance, argued that firms should be permitted to label or qualify the mark-up/mark-down disclosed on the confirmation as "estimated" or "approximate."¹³⁴ Commenters therefore suggested that members be allowed to add a description of the member's process for calculating mark-ups and mark-downs¹³⁵ or to explain that the determination of PMP for a particular security may not be identical across firms.¹³⁶ Others suggested that members be permitted to describe the meaning of the mark-up/mark-down,¹³⁷ or to indicate that it may not reflect profit to the member¹³⁸ or the exact compensation to the member.¹³⁹ One commenter suggested that, to "standardize retail investor understanding," acceptable explanatory text should be drafted and prepared by FINRA.¹⁴⁰

FINRA responded by reiterating that the determination of the PMP of a particular security may not be identical across firms.¹⁴¹ According to FINRA, this is the reason that it will expect members to have reasonable policies and procedures in place to determine PMP and to

¹³³ See PIABA, at 2.

¹³⁴ See Fidelity, at 3; SIFMA, at 4.

¹³⁵ See Wells Fargo, at 4; Fidelity, at 3.

¹³⁶ See SIFMA, at 4.

¹³⁷ See Fidelity, at 3.

¹³⁸ See Wells Fargo, at 4-5; SIFMA, at 4. See also Thomson Reuters II, at 3 (noting that firms may not want to provide mark-up/mark-down disclosure on all confirms without the ability to include text indicating that the mark-up/mark-down may not reflect the profit to the firm).

¹³⁹ See Fidelity, at 3.

¹⁴⁰ Id.

¹⁴¹ See FINRA Response Letter, at 10.

apply these policies and procedures consistently across customers.¹⁴² FINRA also made clear that it does not believe that members should be permitted to label the required mark-up/mark-down disclosure as an “estimate” or an “approximate” figure, as such labels have the potential to unduly suggest an unreliability of the disclosures or otherwise diminish their value.¹⁴³ However, FINRA believes that a member would not be prohibited 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 are accurate.¹⁴⁴ In response to commenters’ requests for FINRA to provide standardized or sample disclosures that would be appropriate under the proposal, FINRA represented that it will engage with members to evaluate the potential need for and use of such guidance.¹⁴⁵

D. Harmonization with the MSRB Proposal and Amendment No. 1

Commenters generally urged harmonization with the MSRB Proposal,¹⁴⁶ focusing mostly on the MSRB’s proposal to require firms to include a security-specific hyperlink to EMMA and the execution time of the customer’s trade on the confirmation,¹⁴⁷ and FINRA’s statement that it would propose those requirements in a separate filing.¹⁴⁸

¹⁴² See id.

¹⁴³ See id.

¹⁴⁴ See id.

¹⁴⁵ See id.

¹⁴⁶ See, e.g., Wells Fargo, at 2; BDA, at 2; SIFMA, at 2-3; Thomson Reuters II, at 1-2. See also Investor Advocate, supra note 7, at 6.

¹⁴⁷ See MSRB Proposal, supra note 13, at 62950-62951.

¹⁴⁸ See Notice, supra note 3, at 55502 n.14.

Although two commenters urged FINRA and the MSRB to harmonize their approach, they did not address the substance of the MSRB’s proposal to include a security-specific hyperlink to EMMA.¹⁴⁹ However, two other commenters expressly opposed the inclusion of a security-specific hyperlink, despite their general support for harmonization with the MSRB.¹⁵⁰ These commenters asserted that customers who typically receive paper confirmations would likely not type in the long universal resource locator (“URL”) of a security-specific hyperlink into an internet browser.¹⁵¹ One commenter also stated that it would be difficult to maintain security-specific hyperlinks¹⁵² and that inclusion of a security-specific hyperlink would reduce the amount of space available on an already-crowded confirmation.¹⁵³ The other commenter believed that FINRA should provide only a general hyperlink to publicly available TRACE

¹⁴⁹ See BDA, at 2; SIFMA, at 12. In subsequent letters regarding the MSRB Proposal, however, both commenters recommended that FINRA and the MSRB allow firms to provide a general hyperlink to TRACE and/or EMMA, rather than a security-specific hyperlink. See Letter from Mike Nicholas, Chief Executive Officer, Bond Dealers of America, to Brent J. Fields, Secretary, Securities and Exchange Commission (Oct. 4, 2016) (“BDA II”), at 4; Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, Municipal Securities Division, and Sean Davy, Managing Director, Capital Markets Division, SIFMA, to Brent J. Fields, Secretary, Securities and Exchange Commission (Oct. 3, 2016) (“SIFMA II”), at 13. They nevertheless continued to stress harmonization as the critical point. See *id.*

¹⁵⁰ See Thomson Reuters II, at 3; FIF, at 9.

¹⁵¹ See Thomson Reuters II, at 3 (also stating that investors typing in a long URL would make mistakes in doing so); FIF, at 9. See also SIFMA II, at 13 (stating that investors typing in a long URL would make mistakes in doing so).

¹⁵² See FIF, at 8. See also BDA II, at 4 (noting that dealers are concerned that web addresses to specific security pages may change without their knowledge).

¹⁵³ See FIF, at 8. In a subsequent letter regarding the MSRB Proposal, however, FIF made it clear that their preference was to remove the requirement for a hyperlink altogether. See Letter from Mary Lou Von Kaenel, Managing Director, Financial Information Forum, to Brent J. Fields, Secretary, Securities and Exchange Commission (Oct. 4, 2016) (“FIF II”), at 8. See also SIFMA II, at 13 (noting that a short, general hyperlink would reduce the amount of space needed on a confirmation to fulfill the requirement).

data.¹⁵⁴ One commenter suggested that FINRA delay any requirement to include a hyperlink to TRACE on customer confirmations until the mark-up/mark-down disclosure requirement had been fully implemented.¹⁵⁵

With respect to the inclusion of the time of trade on customer confirmations, two commenters urged FINRA and the MSRB to harmonize their approach, but did not address the substance of the MSRB's proposal to include the time of trade on customer confirmations.¹⁵⁶ One commenter, despite its general support for harmonization with the MSRB Proposal, opposed the inclusion of the time of the trade on customer confirmations, stating that including the time of trade would not only be costly, but that mark-up/mark-down disclosure would obviate the need for this disclosure.¹⁵⁷ This commenter also stressed the practical difficulties on providing this disclosure.¹⁵⁸ One commenter suggested that FINRA delay any requirement to include the

¹⁵⁴ See Thomson Reuters II, at 3. See also BDA II, at p. 4 (recommending that FINRA and the MSRB provide a general hyperlink to search page); SIFMA II, at 13 (recommending that FINRA and the MSRB allow firms to provide a general hyperlink).

¹⁵⁵ See SIFMA, at 12. In subsequent letters regarding the MSRB Proposal, three commenters added recommendations that the MSRB delay action on this particular issue in order to coordinate with FINRA. See FIF II, at 8; Letter from Norman L. Ashkenas, Chief Compliance Officer, Fidelity Brokerage Services, LLC, and Richard J. O'Brien, Chief Compliance Officer, National Financial Services, LLC, to Brent J. Fields, Secretary, Securities and Exchange Commission (Oct. 4, 2016) ("Fidelity II"), at 5; Letter from Robert J. McCarthy, Director of Regulatory Policy, Wells Fargo Advisors, LLC, to Brent J. Fields, Secretary, Securities and Exchange Commission (Oct. 4, 2016) ("Wells Fargo II"), at 5.

¹⁵⁶ See BDA, at 2; SIFMA, at 12.

¹⁵⁷ See FIF, at 8.

¹⁵⁸ See id. (expressing concerns about providing this disclosure in the context of trade modifications, cancellations or corrections, and in the context of block trades subsequently allocated to sub-accounts). Fidelity did not address this issue in its letter regarding the FINRA proposal, but it did echo the concerns expressed by FIF in a subsequent letter regarding the MSRB Proposal. See Fidelity II, at 5.

time of trade on customer confirmations until the mark-up/mark-down disclosure requirement had been fully implemented.¹⁵⁹

In response, FINRA agreed with commenters that it was important to harmonize with the MSRB on both of these items.¹⁶⁰ FINRA pointed out that it solicited comments on these potential requirements in the Revised Proposal and that it had reviewed the comments submitted to the MSRB regarding its proposal.¹⁶¹ After reviewing all such comments, FINRA determined that it was appropriate to require disclosure of a security-specific hyperlink to TRACE and time of execution on customer confirmations, and it further stated that the additional requirements could be implemented in a way that would mitigate the concerns raised by commenters.¹⁶² Accordingly, FINRA submitted Amendment No. 1 to propose requirements that it believes to be “identical to the MSRB’s proposed requirements in all material respects,” stating that this would further a “more harmonized implementation schedule.”¹⁶³

E. Anticipated Costs of Implementing the Proposed Rule Change by the Proposed Effective Date

Several commenters stated that the cost and complexity of the proposed rule change would make it difficult to implement by the proposed effective date. Commenters particularly emphasized the need for significant systems and programming modifications on their part and on

¹⁵⁹ See SIFMA, at 12. In subsequent letters regarding the MSRB Proposal, two commenters added recommendations that the MSRB delay action on this particular issue in order to coordinate with FINRA. See FIF II, at 8; Fidelity II, at 5.

¹⁶⁰ See FINRA Response Letter, at 11.

¹⁶¹ See id.

¹⁶² See id. See also Amendment No. 1, supra note 9, at 12.

¹⁶³ See Amendment No. 1, supra note 9, at 4.

the part of their third-party vendors.¹⁶⁴ They also asserted that it would be particularly challenging to implement such changes in light of other regulatory initiatives slated to become effective in the near future.¹⁶⁵ One commenter requested that FINRA or the Commission perform additional outreach to the industry to gather information on the operational costs,¹⁶⁶ while two commenters felt the burdens imposed by the proposal were so high that they questioned whether an adequate cost-benefit analysis had been performed.¹⁶⁷

In light of these issues, most commenters urged FINRA and the MSRB to agree on a harmonized implementation time frame longer than the one-year period set forth in the proposal. Commenters suggested time frames ranging from 18 months to three years.¹⁶⁸ Two commenters further proposed a phased approach that would first focus on PMP determination and then focus

¹⁶⁴ See, e.g., FIF, at 1-2, 7; Fidelity, at 5.

¹⁶⁵ See BDA, at 2-3; SIFMA, at 11-12; Fidelity, at 5-6; Thomson Reuters II, at 4; FIF, at 2. Commenters identified the following initiatives: (1) the U.S. Department of Labor's conflict of interest rule, see 81 FR 20946 (Apr. 8, 2016); (2) amendments to FINRA Rule 4210 for mortgage security margin, see Securities Exchange Act Release No. 76148 (Oct. 14, 2015), 80 FR 63603 (Oct. 20, 2015) (FINRA-2016-036); (3) the proposed transition to a T+2 settlement cycle, see Securities Exchange Act Release No. 78962 (September 28, 2016), 81 FR 69240 (October 5, 2016); (4) amendments to TRACE to support Treasuries, see Securities Exchange Act Release No. 78359 (July 19, 2016), 81 FR 48465 (July 25, 2016) (FINRA-2016-027); (5) the Consolidated Audit Trail, see Securities Exchange Act Release No. 77724 (Apr. 27, 2016), 81 FR 30614 (May 17, 2016); and (6) the Financial Crimes Enforcement Network's Customer Due Diligence Requirements for Financial Institutions, see 81 FR 29398 (May 11, 2016).

¹⁶⁶ See BDA, at 4.

¹⁶⁷ See SIFMA, at 2; FIF, at 3.

¹⁶⁸ See BDA, at 3 (requesting an 18-month period); FIF, at 3 (requesting a minimum of 18-21 months); Fidelity, at 5 (requesting a two-year period); Thomson Reuters II, at 4 (requesting a two- to three-year period); Wells Fargo, at 4 (requesting a three-year period, while acknowledging that a shorter time frame might be feasible); SIFMA, at 11-12 (requesting a three-year period, while acknowledging that a shorter time frame might be feasible). In a subsequent letter regarding the MSRB Proposal, BDA requests a two-year period. See BDA II, at 4-5.

on calculation of the mark-up/mark-down and presentation of this information on customer confirmations.¹⁶⁹

By contrast, one commenter and the Investor Advocate believed that a one-year implementation period was reasonable.¹⁷⁰ The commenter argued that the benefits of the proposed rule change far outweighed any associated costs.¹⁷¹ This commenter noted that firms already have an obligation to calculate mark-ups/mark-downs in compliance with FINRA Rule 2121 and maintained that the proposal would impose a limited burden, insofar as it only requires members to provide disclosure in instances when offsetting sales (purchases) occur within the same trading day.¹⁷² Furthermore, this commenter believed that the proposed mark-up/mark-down disclosures might actually stimulate the market by increasing investor confidence, which could create more competitive prices and reduce transaction costs.¹⁷³

FINRA responded that it continues to believe that the proposal is justified.¹⁷⁴ FINRA stated that it “included significant economic analysis in the [p]roposal, 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.”¹⁷⁵ FINRA represented that it understands the cost concerns expressed by commenters and the firms FINRA has spoken with, particularly those associated with altering the current practice of near straight-through processing of

¹⁶⁹ See Fidelity, at 6; FIF, at 3.

¹⁷⁰ See UMiami, at 3; Investor Advocate, supra note 7, at 10-11.

¹⁷¹ See UMiami, at 3.

¹⁷² See UMiami, at 2-3.

¹⁷³ See UMiami, at 3.

¹⁷⁴ See FINRA Response Letter, at 12. See also Amendment No. 1, supra note 9, at 12.

¹⁷⁵ See FINRA Response Letter, at 12.

confirmations after a transaction and the potential for regulatory and legal risk associated with errors, but added that it has received no additional data about the magnitude of these costs.¹⁷⁶

FINRA stated that the proposal's economic impact assessment was premised on the adherence to FINRA Rule 2121 guidance by members, and thus, for members that are not reasonably following FINRA Rule 2121's step-by-step guidance to determine PMP in the manner they would need to under the proposal, the implementation costs of the proposal may be substantially higher than for other firms.¹⁷⁷ 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 was sufficient and appropriate.¹⁷⁸ FINRA also believes that the guidance provided in the FINRA Response Letter may reduce the potential costs or burdens of the proposal.¹⁷⁹ To further reduce potential costs or burdens, FINRA further noted that it was proposing in Amendment No. 1 to harmonize the proposal with the MSRB Proposal, as amended, and extend the implementation time frame from one year to 18 months.¹⁸⁰

F. Recommendation of the Investor Advocate

As noted above, the Investor Advocate submitted to the public comment file its recommendation to the Commission that the Commission approve the proposed rule change.¹⁸¹ In its recommendation, the Investor Advocate stated its belief that the proposed rule change's "enhancements to pricing disclosure in the fixed income markets are long overdue and will

¹⁷⁶ See id.

¹⁷⁷ See id.

¹⁷⁸ See id.

¹⁷⁹ See id.

¹⁸⁰ See FINRA Response Letter, at 11, 13; see also Amendment No. 1, supra note 9, at 3.

¹⁸¹ See Investor Advocate, supra note 7.

greatly benefit retail investors.”¹⁸² Specifically, the Investor Advocate noted that the required mark-up/mark-down disclosures will better equip retail investors “to evaluate transactions and the quality of service provided to them by a firm,” help regulators and retail investors detect improper dealer practices, and make it less likely that dealers will charge excessive mark-ups.¹⁸³ Ultimately, the Investor Advocate focused its attention on “four key issues” – consistency of approach between FINRA and the MSRB; same-day disclosure window; the use of PMP as the basis for calculating mark-ups; and the need for dealers to look through transactions with affiliates – as the focus of its review, and stated “each of these issues has been resolved to our satisfaction” in the proposed rule change.¹⁸⁴

With respect to FINRA and the MSRB adopting consistent rules related to confirmation disclosure, the Investor Advocate highlighted that the proposed rule change and the MSRB Proposal “provide a coordinated and consistent approach to mark-up disclosure in corporate and municipal bond transactions.”¹⁸⁵ Accordingly, the Investor Advocate concluded that “this deliberative approach will lead to consistent disclosures across the fixed income markets and will provide retail investors with better post-trade price transparency.”¹⁸⁶

Addressing the same-day disclosure window, the Investor Advocate noted its agreement “that the window of time for disclosure should be the full trading day.”¹⁸⁷ According to the Investor Advocate, a shorter time-frame – e.g., the two-hour window previously proposed by the

¹⁸² See Investor Advocate, supra note 7, at 2.

¹⁸³ See id.

¹⁸⁴ See Investor Advocate, supra note 7, at 6.

¹⁸⁵ See id.

¹⁸⁶ See id.

¹⁸⁷ See Investor Advocate, supra note 7, at 7.

MSRB – could inappropriately incentivize dealers to alter their trading practices to avoid the obligation to disclose mark-ups.¹⁸⁸

Discussing the proposed rule change’s use of PMP as the basis for mark-up disclosure, the Investor Advocate stated its belief that the PMP-based disclosure has advantages over the initially proposed reference price-based disclosure.¹⁸⁹ Specifically, the Investor Advocate noted that though the “PMP-based disclosure may lead to disclosure of a smaller cost to retail investors under certain circumstances . . . the PMP-based approach provides retail investors with the relevant information about the actual compensation the retail investor is paying the dealer for the transaction . . . [and] . . . [i]t reflects market conditions and has the potential to provide a more accurate benchmark for calculating transaction costs.”¹⁹⁰ Moreover, the Investor Advocate notes that the PMP-based disclosure regime could more easily be expanded beyond the presently contemplated same-day disclosure window.¹⁹¹ As a result, the Investor Advocate stated its support for the use of the PMP-based disclosure regime.¹⁹² Finally, the Investor Advocate stated its support for the proposed rule change’s requirement that dealers express the mark-up both as a total dollar amount and as a percentage of the PMP.¹⁹³

With respect to dealer transactions with affiliates, the Investor Advocate highlighted its concern with dealer-affiliate trading arrangements, and concluded that the proposed rule change

¹⁸⁸ See id.

¹⁸⁹ See id.

¹⁹⁰ See Investor Advocate, supra note 7, at 7-8.

¹⁹¹ See Investor Advocate, supra note 7, at 8.

¹⁹² See Investor Advocate, supra note 7, at 8-9.

¹⁹³ See Investor Advocate, supra note 7, at 9.

“satisfies [the Investor Advocate’s] concerns by making clear that a dealer must look through non-arms-length transactions with affiliates to calculate PMP.”¹⁹⁴

Finally, with respect to the implementation of the proposed rule change, the Investor Advocate stated its support for a one-year implementation period, noting that such period would be reasonable despite the technical and system changes that might be required for compliance with the proposed rule change.¹⁹⁵

G. Amendment No. 1

To complement the mark-up/mark-down disclosure proposal and further harmonize its proposal with the MSRB Proposal, FINRA proposes in Amendment No. 1 to require that for all transactions in corporate or agency debt securities with non-institutional customers, irrespective of whether mark-up/mark-down disclosure is required, the member provide on the confirmation the following additional information: (1) a reference, and a hyperlink if the confirmation is electronic, to a web page hosted by FINRA that contains TRACE publicly available trading data for the specific security that was traded, in a format specified by FINRA, along with a brief description of the type of information available on that page; and (2) the execution time of the transaction, expressed to the second.¹⁹⁶

In support of the Amendment, FINRA notes that four commenters – BDA, Thomson Reuters, SIFMA, and FIF – addressed FINRA’s statement in the Notice that it intended to submit

¹⁹⁴ See Investor Advocate, supra note 7, at 9-10.

¹⁹⁵ See Investor Advocate, supra note 7, at 10-11.

¹⁹⁶ See Amendment No. 1, supra note 9, at 5; proposed Rule 2232(e). As discussed above, FINRA also proposes in Amendment No. 1. to add the term “offsetting” to proposed Rule 2232(c)(2) to conform the rule language to the language used to discuss conditions that trigger the disclosure requirement, and extend the implementation period of the proposal from one year to 18 months. See Amendment No. 1, supra note 9, at 3. See also supra notes 75-77 and accompanying text.

an additional filing to require members to add disclosures to non-institutional confirmations of the time of trade and a hyperlink to trade data reported to TRACE, and that three of these commenters asked that FINRA conform its forthcoming filing to parallel requirements included in the MSRB Proposal.¹⁹⁷ In addition, in support of the proposed additional requirements, FINRA discusses comments received on the Initial and Revised Proposals. Regarding the reference/hyperlink to TRACE, FINRA notes that one commenter stated in response to Regulatory Notice 14-52 that providing CUSIP-specific hyperlinks to TRACE on customer confirmations would be “fairly easy” if FINRA adopts a retail customer-friendly hyperlink protocol.¹⁹⁸ In addition, FINRA states that three commenters on Regulatory Notice 15-36 supported adding a hyperlink to TRACE data in some form,¹⁹⁹ although one commenter requested a short URL²⁰⁰ and one preferred a general hyperlink to the TRACE website.²⁰¹ Regarding comments on the proposed requirement to disclose the time of the execution of the customer transaction, FINRA notes that some commenters on Regulatory Notice 15-36 supported including the time of execution of the customer trade because it would allow customers to identify their trade on TRACE and understand the market for the security at the time of their trade,²⁰² and that others²⁰³ opposed it as unnecessary and costly.

¹⁹⁷ See Amendment No. 1, supra note 9, at 4. FINRA noted that the Investor Advocate also stated generally that it is important for FINRA and the MSRB to adopt consistent rules related to confirmation disclosure. Id.

¹⁹⁸ See Amendment No. 1, supra note 9, at 10.

¹⁹⁹ See Amendment No. 1, supra note 9, at 11.

²⁰⁰ See id.

²⁰¹ See Amendment No. 1, supra note 9, at 12.

²⁰² See Amendment No. 1, supra note 9, at 11.

²⁰³ See id.

FINRA represents that it also has evaluated the comments submitted on the MSRB Proposal, which includes the proposed additional requirements.²⁰⁴ FINRA states that the commenters that opposed these elements of the MSRB's Proposal did so primarily on the basis of harmonization, because FINRA had not yet proposed the same requirements, and on the basis of operational cost or burden.²⁰⁵

FINRA believes that the proposed additional requirements are consistent with the Act because they will provide retail customers with meaningful and useful additional information that is either not readily available through existing data sources, or is not always known or easily accessible to investors.²⁰⁶ FINRA notes that its conduct of investor testing indicated that investors would find the proposed additional information useful, and that their inclusion will better enable customers to evaluate the cost of the services that members provide, and will promote transparency into members' pricing practices and encourage communications between members and their customers about the execution of their fixed income transactions.²⁰⁷

Addressing cost concerns that commenters have raised regarding the proposed additional requirements,²⁰⁸ FINRA represents that it is developing technology that it believes may mitigate costs associated with modifying systems to include the required security-specific reference or hyperlink to TRACE data prior to the rule's implementation date.²⁰⁹ In addition, while FINRA

²⁰⁴ See Amendment No. 1, supra note 9, at 12.

²⁰⁵ See id.

²⁰⁶ See Amendment No. 1, supra note 9, at 7.

²⁰⁷ See id.

²⁰⁸ See Amendment No. 1, supra note 9, at 9.

²⁰⁹ See Amendment No. 1, supra note 9, at 9-10. Specifically, FINRA is in the process of developing a webpage linkage system that will create a short, uniform hyperlink template that could be included on customer confirmations. FINRA anticipates that the

recognizes that there will be operational burdens associated with the time of execution requirement, FINRA believes that the systems to capture this information for provision to customers should already be in place, given that current rules already require members to capture and maintain this information with respect to each customer transaction.²¹⁰ As a result, FINRA expects the cost to implement the proposed additional requirements to be limited.²¹¹

FINRA represents that it has thoroughly and carefully evaluated all of the comments that relate to the additional requirements it proposes in Amendment No. 1, and believes it is appropriate to pursue these requirements as an amendment to the proposal in response to the strong call from commenters to harmonize the proposed disclosure requirements put forth by FINRA and the MSRB.²¹² In addition, FINRA believes it has modified the requirements in a way that significantly mitigates the operational concerns that commenters have identified, particularly with respect to the format for the required reference or hyperlink to TRACE data.²¹³ FINRA also notes that it is extending the implementation timeline for the proposal from one year to eighteen months, which it believes should mitigate the commenters' potential concerns with

hyperlink template would include a short domain name followed by a slash and the specific security CUSIP. FINRA believes that, by developing this short, uniform hyperlink template, it can limit the space required on each confirmation for the required TRACE reference or hyperlink. FINRA also believes a short, uniform hyperlink template would make automation of the requirement more feasible, since the hyperlink would only include two pieces of information: (1) the short domain name, which would remain constant; and (2) the security-specific CUSIP, which members already include on customer confirmations. FINRA intends to work with firms to obtain input and expects to finalize and publish the short uniform hyperlink template well before the rule takes effect, with sufficient time for further feedback and implementation.

²¹⁰ See Amendment No. 1, supra note 9, at 7.

²¹¹ See Amendment No. 1, supra note 9, at 9.

²¹² See Amendment No. 1, supra note 9, at 10-12.

²¹³ See Amendment No. 1, supra note 9, at 12.

these requirements even further.²¹⁴ FINRA believes that the extension of the time period for implementation of the rule is an appropriate balance of the commenters' concerns and the desire to begin delivering additional pricing information to retail customers.²¹⁵

IV. Discussion and Commission Findings

After carefully considering the proposed rule change, the comments received, the FINRA Response Letter, and Amendment No. 1, the Commission finds that the proposed rule change, as modified by Amendment No.1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association. In particular, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with Section 15A(b)(6) of the Act,²¹⁶ which requires, among other things, that FINRA's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, and Section 15A(b)(9) of the Act,²¹⁷ which requires the rules of a national securities association not impose any burden on competition not necessary or appropriate in furtherance of the Exchange Act.

A. Mark-up/Mark-down Disclosure

The Commission notes that the goal of improving transaction cost transparency in fixed-income markets for retail investors has long been pursued by the Commission.²¹⁸ The

²¹⁴ See id.

²¹⁵ See id.

²¹⁶ 15 U.S.C. 78o-3(b)(6).

²¹⁷ 15 U.S.C. 78o-3(b)(9).

²¹⁸ See Securities & Exchange Commission, Report on the Municipal Securities Market (July 31, 2012) ("2012 Report"), available at: <https://www.sec.gov/news/studies/2012/munireport073112.pdf> (recommending that the

Commission believes that the establishment of a requirement that FINRA members disclose mark-ups/mark-downs to retail investors, as proposed, will advance the goal of providing retail investors with meaningful and useful information about the pricing of their fixed-income transactions.²¹⁹

The Commission believes the proposal, as modified by Amendment No. 1, is reasonably designed to ensure that mark-ups/mark-downs are disclosed to retail investors, at least when a member has effected a same-day off-setting transaction, while limiting the impact of operational

MSRB consider possible rule changes that would require dealers acting on a riskless principal basis to disclose on the customer confirmation the amount of any mark-up or mark-down and that Commission consider whether a comparable change should be made to Rule 10b-10 with respect to confirmation disclosure of mark-ups and mark-downs in riskless principal transactions for corporate bonds); Chair Mary Jo White, Securities and Exchange Commission, Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors (June 20, 2014), available at: <https://www.sec.gov/News/Speech/Detail/Speech/1370542122012> (Chair White noting that to help investors better understand the cost of their fixed income transactions, staff will work with FINRA and the MSRB in their efforts to develop rules regarding disclosure of mark-ups in certain principal transactions for both corporate and municipal bonds); Statement on Edward D. Jones Enforcement Action (August 13, 2015), available at: <https://www.sec.gov/news/statement/statement-on-edward-jones-enforcement-action.html> (Commissioners Luis A. Aguilar, Daniel M. Gallagher, Kara M. Stein, and Michael S. Piwowar, stating, “We encourage the Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB) to complete rules mandating transparency of mark-ups and mark-downs, even in riskless principal trades.”). See also Investor Advocate, supra note 7, at 2 (supporting the proposed rule change and stating that enhancements to pricing disclosure in the fixed-income markets are “long overdue and will greatly benefit retail investors”); Recommendation of the Investor Advisory Committee to Enhance Information for Bond Market Investors (June 7, 2016), available at: <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-enhance-information-bond-market-investors-060716.pdf> (recommending that the Commission work with FINRA and the MSRB to finalize mark-up/mark-down disclosure proposals).

²¹⁹ As FINRA notes, while SEC Rule 10b-10 requires members to provide pricing information, including transaction cost information, in connection with a purchase or sale of equity securities where the member acted as principle, no comparable requirement currently exists for transactions in fixed-income securities. See 17 CFR 240.10b-10(a)(2); Notice, supra note 3, at 55500.

challenges for members. For example, in response to commenters concerned that the proposal would disrupt intra-day confirmation generation processes, FINRA has clarified that members need not wait until the end of the day to determine the information to be included in a confirmation, and may maintain real-time, intra-day confirmation generation processes; and, further, that members will not be expected to send revised confirmations solely based on the occurrence of a subsequent transaction or event that would otherwise be relevant to the determination of PMP under FINRA Rule 2121.02.²²⁰

Under the proposal, disclosed mark-ups/mark-downs are to be calculated in compliance with FINRA Rule 2121, and expressed as a total dollar amount and as a percentage of the PMP.²²¹ The Commission believes that this information will, for example, promote transparency of members' pricing practices and encourage dialogue between members and retail investors about the costs associated with their transactions, thereby better enabling retail investors to evaluate their transaction costs and potentially promoting price competition among member firms.

As discussed above, concerns were raised that the proposal's requirement to determine PMP in compliance with FINRA Rule 2121 and the supplementary material thereunder would make it difficult for members to automate PMP determinations at the time of the trade.²²² The Commission believes that FINRA has adequately responded to these concerns, and that the price and mark-up/mark-down disclosed to the customer on a confirmation must reflect the actual PMP the member used to price and mark-up/mark-down the transaction at the time of the trade.

²²⁰ See supra notes 128-130 and accompanying text.

²²¹ See Notice, supra note 3, at 55500-55502.

²²² See notes 90-96, supra, and accompanying text.

The Commission believes that it is feasible to automate the determination of PMP in accordance with FINRA Rule 2121 to the extent a member chooses to do so, and agrees with FINRA that a firm's election to use automated processes to support pricing of retail trades, and thus determine the PMP, would not justify departure from the current requirement that members price securities in accordance with FINRA Rule 2121.²²³ When it approved FINRA Rule 2121.02, the Commission stated that such guidance is consistent with long-standing Commission and judicial precedent regarding fair mark-ups, and that it:

provides a framework that specifically establishes contemporaneous cost as the presumptive prevailing market price, but also identifies certain dynamic factors that are relevant to whether contemporaneous cost or alternative values provide the most appropriate measure of prevailing market price. The Commission believes that the factors that govern when a dealer may depart from contemporaneous cost and that set forth alternative measures the dealer may use are reasonably designed to provide greater certainty to dealers and investors while providing an appropriate level of flexibility for dealers to consider alternative market factors when pricing debt securities.²²⁴

The Commission believes this reasoning remains sound and is not persuaded that the proposed requirement to disclose mark-ups/mark-downs on customer confirmations necessitates an approach contrary to FINRA Rule 2121.02.

Further, in response to commenters that requested additional guidance concerning how they could develop reasonable policies and procedures to comply with the rule,²²⁵ FINRA states that members may rely on reasonable policies and procedures to facilitate the determination of PMP, provided they do so consistent with FINRA Rule 2121.²²⁶ More specifically, FINRA

²²³ See notes 103-106, *supra*, and accompanying text.

²²⁴ See Securities Exchange Act Release No. 55638 (Apr. 16, 2007), 72 FR 20150, 20154 (Apr. 23, 2007) (NASD-2003-141).

²²⁵ See notes 97-102, *supra*, and accompanying text.

²²⁶ See note 108, *supra*, and accompanying text.

explained that a member could, for example, develop reasonable policies and procedures to: (i) employ a methodology to determine PMP when there are multiple principal trades that offset one or more customer trades subject to disclosure; (ii) 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; and/or (iii) employ the use of economic models provided by a third-party pricing service.²²⁷ Because the determination of the PMP of a particular security may not be identical across firms, FINRA will expect members to have reasonable policies and procedures in place to determine PMP and to apply these policies and procedures consistently across customers.²²⁸ FINRA also has proposed to extend the implementation date of the proposal, as modified by Amendment No. 1, from one year to 18 months,²²⁹ and represented that it will work closely with the industry and MSRB during the rule's implementation period to issue further guidance as necessary.²³⁰ The Commission believes FINRA's response appropriately addresses commenters' concerns regarding implementation of the proposal.

Also, as discussed above, commenters had questions regarding the presentation of mark-up/mark-down information on customer confirmations, and in particular sought FINRA's concurrence that it would be acceptable to label the required mark-up/mark-down disclosure as an "estimate" or an "approximate" figure.²³¹ The Commission agrees with FINRA,²³² and does

²²⁷ See notes 109-121, supra, and accompanying text.

²²⁸ See note 141-142, supra, and accompanying text.

²²⁹ See Amendment No. 1, supra note 9, at 12.

²³⁰ See note 122, supra, and accompanying text.

²³¹ See notes 132-140, supra, and accompanying text.

²³² See notes 141-145, supra, and accompanying text.

not believe that it would be consistent with the Act or the proposal for members to label the required mark-up/mark-down disclosure as an “estimate” or an “approximate” figure, or to otherwise suggest that the member is not disclosing the actual amount of the mark-up/mark-down it determined to charge the customer. However, the proposal is appropriately flexible to permit a member to include language on confirmations that explains PMP as a concept, or that details the member’s methodology for determining PMP, or notes the availability of information about methodology upon request, provided such statements are accurate.²³³ The Commission emphasizes that members will be required to disclose the actual amount of the mark-up/mark-down that they have determined to charge the customer, in accordance with FINRA Rule 2121, and the amendments to FINRA Rule 2232 being approved hereby.

B. Harmonization with the MSRB Proposal: Requirement to Provide TRACE Reference/Hyperlink and Time of Execution on All Non-Institutional Customer Confirmations

The Commission also believes that FINRA’s proposal to require members to reference (or include, if the confirmation is electronic) a security-specific hyperlink to a web page hosted by FINRA that contains TRACE publicly available trade data and to disclose the time of trade execution on all retail trade confirmations, is reasonably designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to protect investors, and in the public interest, and does not impose any burden on competition not necessary or appropriate in furtherance of the Act, and is therefore consistent with the Act.

In the Commission’s view, providing a retail investor with a security-specific reference or hyperlink on the trade confirmation and the time of trade execution will facilitate retail customers obtaining a comprehensive view of the market for their securities, including the

²³³ See notes 144-145, supra, and accompanying text.

market as of the time of trade. The Commission believes that these items will complement FINRA's existing order-handling obligations (e.g., best execution) by providing retail investors with meaningful and useful information with which they will be able to independently evaluate the quality of execution obtained from a firm.

Although some commenters urged a general hyperlink to TRACE publicly available trade data, rather than a security-specific hyperlink,²³⁴ FINRA believes that a security-specific hyperlink will better enable retail investors, who typically have less ready access to market and pricing information than institutional customers, to access important data related to fixed-income securities, providing them with a more comprehensive picture of the market for a security on a given day, and ultimately assist them in understanding and comparing the transaction costs associated with their purchases and sales of fixed income securities.²³⁵ Further, in Amendment No. 1, FINRA represents that the proposed requirements can be implemented in a way that mitigates the concerns raised by commenters, as FINRA intends to develop technology that it believes may reduce the costs associated with modifying systems to include the required security-specific reference or hyperlink prior to the rule's implementation date.²³⁶ The Commission has carefully considered Amendment No. 1 in light of comments received urging FINRA and the MSRB to harmonize both the substance and timing of their proposals,²³⁷ as well comments submitted on the MSRB Proposal which proposed analogous requirements.²³⁸ The

²³⁴ See notes 150-154, supra, and accompanying text.

²³⁵ See Amendment No. 1, supra note 9, at 6.

²³⁶ See Amendment No. 1, supra note 9, at 9.

²³⁷ See note 146, supra, and accompanying text.

²³⁸ See Wells Fargo II; Fidelity II; BDA II; FIF II; SIFMA II; Thomson Reuters II. See also Letter from Paige W. Pierce, President and CEO, RW Smith & Associates, LLC, to Brent J. Fields, Secretary, Commission (Oct. 4, 2016).

Commission concurs with FINRA that the time of execution along with a security-specific reference or hyperlink on a customer confirmation would provide customers with the ability to obtain a comprehensive view of the market for their security at the time of trade.

C. Efficiency, Competition, and Capital Formation

In approving the proposed rule change, as modified by Amendment No. 1, the Commission has considered its impact on efficiency, competition, and capital formation.²³⁹ The Commission believes that the proposed rule change, as modified by Amendment No. 1, could affect efficiency, competition, and capital formation in several ways.

The Commission believes that the proposed rule could have an impact on competition among broker-dealers. For instance, costs associated with the proposed rule could raise barriers to entry in the non-institutional trading market. Further, in the Notice, FINRA considers the possibility that the mark-up/mark-down disclosure proposal could have a differing operational impact and costs across members.²⁴⁰ FINRA acknowledges that the proposal could result in higher costs for small broker-dealers and broker-dealers less active in non-institutional trading, that the proposed rule could lead small broker-dealers to consolidate with large broker-dealers, or to exit the market, but believes that FINRA's data analysis suggested that this effect could be limited.²⁴¹ Additionally, the Commission believes that the proposal provides members with the flexibility to develop cost effective policies and procedures for complying with the proposed rule change, as modified by Amendment No. 1, that reflect their business needs and are consistent with the regulatory objectives of the proposal.

²³⁹ 15 U.S.C. 78c(f).

²⁴⁰ See Notice, supra note 3, at 55505-55506.

²⁴¹ See Notice, supra note 3, at 55506.

By increasing disclosure requirements in non-institutional customer confirmation, the proposed rule could improve efficiency – in particular, price efficiency – and the improvement in pricing efficiency could promote capital formation. The Commission believes that mark-up/mark-down disclosure and the inclusion of a security-specific reference/hyperlink to TRACE data on non-institutional customer confirmations would promote price competition among broker-dealers and improve trade execution quality. An increase in price competition among broker-dealers would lower transaction costs on non-institutional customer trades. To the extent that the proposed rule lowers transaction costs on non-institutional customer trades, the proposed rule could improve the pricing efficiency and price discovery process. The quality of the price discovery process has implications for efficiency and capital formation, as prices that accurately convey information about fundamental value improve the efficiency with which capital is allocated across projects and firms. Furthermore, to the extent that the proposed rule lowers transaction costs on non-institutional customer trades, the proposed rule could lower bond financing costs for projects and firms.

As noted above, the Commission received nine comment letters on the filing. The Commission believes that FINRA considered carefully and responded adequately to the concerns raised by commenters. For all of the foregoing reasons, including those discussed in the FINRA Response Letter, the Commission believes the proposal is reasonably designed to help FINRA fulfill its mandate in Section 15A(b)(6) of the Act which requires that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, and Section 15A(b)(9) of the Act, which requires, among other things, that FINRA’s rules do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

Pursuant to Section 19(b)(5) of the Act,²⁴² the Commission consulted with and considered the views of the Treasury Department in determining whether to approve the proposed rule change, as modified by Amendment No. 1. The Treasury Department did not object to the proposal, as modified by Amendment No. 1. Pursuant to Section 19(b)(6) of the Act,²⁴³ the Commission has considered the sufficiency and appropriateness of existing laws and rules applicable to government securities brokers, government securities dealers, and their associated persons in approving the proposal.

V. Solicitation of Comments on Amendment No. 1

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 1 to the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2016-032 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

²⁴² 15 U.S.C. 78s(b)(5) (providing that the Commission “shall consult with and consider the views of the Secretary of the Treasury prior to approving a proposed rule filed by a registered securities association that primarily concerns conduct related to transactions in government securities, except where the Commission determines that an emergency exists requiring expeditious or summary action and publishes its reasons therefor”).

²⁴³ 15 U.S.C. 78s(b)(6).

All submissions should refer to File Number SR-FINRA-2016-032. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change, as modified by Amendment No. 1, that are filed with the Commission, and all written communications relating to the proposed rule change, as modified by Amendment No. 1, between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing will also be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2016-032 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1

The Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 1, prior to the thirtieth day after the date of publication of notice of the filing of Amendment No. 1 in the Federal Register. Amendment No. 1 supplements the proposed rule change by amending FINRA Rule 2232 to require members to provide the following additional information on customer confirmations: (1) a reference, and a hyperlink if the confirmation is electronic, to a web page hosted by FINRA that contains TRACE publicly available trading data

for the specific security that was traded, in a format specified by FINRA, along with a brief description of the type of information available on that page; and (2) the execution time of the transaction, expressed to the second. FINRA also proposes in Amendment No. 1. to add the term “offsetting” to proposed Rule 2232(c)(2) to conform the rule language to the language used to discuss conditions that trigger the disclosure requirement, and extend the implementation period of the proposal from one year to 18 months.

The Commission finds that requiring members to include a reference or hyperlink to a security-specific TRACE webpage and include the time of trade on all retail customer confirmations is responsive to commenters’ requests for harmonization of the FINRA Proposal and MSRB Proposal and therefore helped the Commission find that the proposed rule change, as modified by Amendment No. 1, is consistent with Section 15A(b)(6) of the Act,²⁴⁴ which requires, among other things, that FINRA’s rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, and Section 15A(b)(9) of the Act,²⁴⁵ which requires, among other things, that FINRA’s rules do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The Commission notes that the addition of the term “offsetting” to the rule is solely a clarification for the avoidance of doubt and that the change does not alter the substance of the rule. Furthermore, extension of the implementation period of the proposal from one year to 18 months is appropriate and responsive to the operational and implementation concerns raised by commenters. The Commission also notes that after consideration of the comments the MSRB received on its proposal to require a security-

²⁴⁴ 15 U.S.C. 78o-3(b)(6).

²⁴⁵ 15 U.S.C. 78o-3(b)(9).

specific hyperlink to EMMA and the execution time of the transaction, the MSRB amended its proposal in a manner that is identical to the Amendment No. 1 that FINRA has filed.²⁴⁶ The Commission notes that it today has approved the MSRB Proposal, as modified by MSRB Amendment No. 1, and believes that in the interests of promoting efficiency in the implementation of both proposals, it is appropriate to approve FINRA's proposal, as modified by Amendment No. 1, concurrently. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Exchange Act,²⁴⁷ to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁴⁸ that the proposed rule change (SR-FINRA-2016-032), as modified by Amendment No. 1, is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁴⁹

Brent J. Fields
Secretary

²⁴⁶ See MSRB Amendment No. 1, supra note 13, at 4-5.

²⁴⁷ 15 U.S.C. 78s(b)(2).

²⁴⁸ 15 U.S.C. 78s(b)(2).

²⁴⁹ 17 CFR 200.30-3(a)(12).

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