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Via Electronic Delivery

September 9, 2016

Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release No. 34-78573; File No. SR-FINRA-2016-032

Dear Mr. Errett,

The Financial Information Forum ("FIF")[1] thanks the Securities and Exchange Commission ("Commission" or "SEC") and the Financial Industry Regulatory Authority ("FINRA") for the opportunity to comment on SR-FINRA-2016-032 - Proposed Rule Change Relating to FINRA Rule 2232 (Customer Confirmations) to Require Members to Disclose Additional Pricing Information on Retail Customer Confirmations Relating to Transactions in Fixed Income Securities ("Proposed Rule").

In commenting on the Proposed Rule changes, FIF is focused on aspects with operational or implementation impacts. This letter is not intended to discuss the challenges associated with determining the Prevailing Market Price ("PMP"), or the pros and cons of using the PMP as a basis for calculating mark-ups or mark-downs. Those may be viewed as "policy issues" as are the requirements to develop the policies and procedures necessary to produce a PMP; and therefore remain outside the scope of FIF's comments related to implementation. As such, FIF will approach the requirements set forth by this rule proposal with the assumption that PMP has been established and must from that point be passed through to the numerous systems that are involved to communicate, capture, calculate, and record the information, as well as format, print and distribute customer confirmations.

This letter is intended to highlight some of the implementation challenges that must be addressed to facilitate this process flow, and to illustrate some of the changes required of all broker-dealers that buy or sell the impacted fixed income securities to "retail customers". The regulations necessitate behavioral changes as well

[1] FIF (www.fif.com) was formed in 1996 to provide a centralized source of information on the implementation issues that impact the securities industry across the order lifecycle. Our participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges. Through topic-oriented working groups, FIF participants focus on critical issues and productive solutions to technology developments, regulatory initiatives, and other industry changes.

as programming changes and extensive coordinated testing. In addition, numerous modifications must be made by many vendor firms that offer order management systems, middle office[2], or back office processing services.

Given the significant number of systems and industry participants that will be impacted by this rule, we are very concerned with the implementation timeframe that will be given to make these deep and far-reaching changes, all while our member firms are at the same time managing the many other mandatory initiatives currently scheduled through 2017. In establishing the effective date, we ask the Commission and FINRA to fully consider our members' ability to allocate the experienced personnel necessary to plan and complete the related tasks, the timing of the effective date (e.g. year-end code freezes), as well as the complexity of what is required to meet this regulation and the breadth of its impacts.

FIF members also wish to impress on FINRA and the Commission the extreme difficulty in implementing this rule proposal as written which requires identification of related trades that would trigger the additional confirmation disclosure, and the need to ascertain "contemporaneous cost" based on either previous or subsequent transactions.[3] Simply put, implementation would entail a convoluted set of procedures that would produce questionable results; and most firms, whether large or small, would be unable to comply with this requirement as proposed without a complete technology reconfiguration and build-out. FIF members instead offer a slightly nuanced alternative that will fully accomplish the objectives this proposal sets out to achieve. Specifically, FIF recommends that the mark-up/mark-down calculation be derived from the Prevailing Market Price (PMP) *in all instances*, which according to FINRA statistics will be the same as the contemporaneous cost most of the time.[4] This approach will provide more consistent results, and although it requires significant work and expense, it is "implementable". Relying on the Prevailing Market Price at all times, rather than searching to identify a potentially related trade to establish contemporaneous cost, will avoid unnecessary complexity and will provide a more realistic calculation of the mark-up/mark-down based on the then-current market price.

We emphasize that even with the FIF recommendation to utilize PMP consistently, the full scope of the changes required is non-trivial; and, coupled with the many other regulatory and industry initiatives currently underway[5], we respectfully request the *maximum amount of time possible* be given to implement this complex rule change.

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[2] Changes will also be required by those that send or receive electronic confirmations via Omgeo or FIX. There are firms that generally use a batch cycle to produce "retail" confirms, but leverage the real-time "institutional ID" process to generate confirms for their high net worth clients who utilize third party custodians, for example. The need to place the added information on the ID confirmation for these clients would seriously disrupt the process and cause widespread consequences. Furthermore, Omgeo and other third party confirmation providers must remediate their systems to accept and fit the additional information into their formats. Electronic recipients (e.g. custodians, investment advisors) must program to receive the information.

[3] FINRA Rule 2121 and Supplementary Material .02

[4] FINRA Regulatory Notice 15-36; page 7. "FINRA also examined the time period separating the customer trades and the corresponding principal trades during the first quarter of 2015. This analysis reveals that approximately 93 percent of retail-sized customer trades in corporate debt securities with same-sized corresponding principal trades occurred within 10 minutes. Similarly, customer and principal trades occurred within 30 minutes of each other for approximately 96 percent and within 2 hours for more than 98 percent of the trades. For trades involving two or more different sized offsetting transactions, the maximum time interval separating the trades was within 10 minutes for approximately 58 percent, and within 2 hours for 82 percent of the trades."

[5] Several of the major implementations that must be completed between September 2017 and January 2018 include: TRACE enhancements to support US Treasuries reporting, the industry move to T+2 settlement, significant changes to meet DOL requirements, and MBS margining.

We also offer the suggestion that this rule proposal be viewed in two parts or phases: 1) determination of the PMP and ability to capture, calculate, and pass the information through the various internal and external systems; and, 2) the ability to apply the information to the confirmation process. Our members preliminarily believe that it will take a bare minimum of one year to complete the first phase, and at least an additional 6-9 months to complete the second phase.

Also of great concern to FIF members is the filing that has only recently been published by the Municipal Securities Rulemaking Board (MSRB). While we have not had sufficient time to examine the details of that proposal, the FINRA and MSRB filings do not appear to be in complete alignment. We note that any differences in approach, terminology, implementation requirements or timeframes could cause significant issues. Furthermore, our members note there are frequently differences in interpretations of guidance and rules across regulators, and even within a single regulatory body, as there are numerous rules and regulations that could have overlapping and potentially conflicting requirements. We hope that a harmonized framework for rule filings, regulatory examination and enforcement will be developed and accessible to all involved parties to avoid such issues.

At this time, we ask that the Commission reserve comment and delay any decisions on FINRA's proposal until the industry has had ample opportunity to assess both proposals and provide feedback and recommendations such that the rules can be implemented in lock-step.

In addition to our request for an ***extended implementation timeframe,*** and the need for ***regulatory harmonization*** discussed above, FIF asks that the regulators carefully consider ***FIF's proposed alternative*** and weigh the extreme difficulty and excessive costs to implement the proposed plan. We also believe that the FIF alternative will provide enhanced disclosure to investors that is perhaps more accurate for reasons described herein. (See Intraday Price Changes Warrant Use of PMP.)

The following provides more detail on FIF members' basic concerns, open questions and key recommendations.

Cost-Benefit Concerns

Directly associated with the extensive changes proposed with this rule filing is the high cost of implementation. FIF members question whether the SEC or FINRA has conducted a cost-benefit analysis for this initiative. While the filing suggests that cost estimates have not been provided by the industry, several FIF members indicated that they provided cost information to FINRA in private meetings rather than in public forums; and, at the same time, they explained to FINRA the varying levels of difficulty and costs involved in implementing the various alternatives proposed in prior filings.

At the time FIF's previous comment letter was written, the specific approach had not been determined and implementation requirements were unknown. While our members were unable to provide accurate estimates, preliminary feedback was provided and emphasized that depending on which approach was selected by the regulators, the implementation costs could extend far beyond clearing firms or other service providers. We highlight the following footnote (FN[6]) extracted from our previous comment letter.

> "Some third-party firms such as clearing firms and other service providers have indicated they will not take responsibility, for both operational and legal reasons, to identify which trade(s) represent the principal trade(s) related to a riskless transaction; therefore, introducing brokers and client firms would need to provide their clearing firm or service provider with the appropriate reference price or contemporaneous cost, which may require matching principal transaction(s) to the riskless trade. Leveraging a feed made available by MSRB and TRACE was described by one clearing firm as the optimal approach, as it would be seamless to the introducing brokers, with an implementation cost less than half

of *the $500,000 estimated to capture contemporaneous cost or another reference price from the introducing broker. This estimate of $500K does not include the cost that would be imposed on the many introducing brokers, which are primarily smaller regional firms, to identify the matching trades."*[6] [Emphasis added.]

The more recent rule proposal mentions that small broker-dealers are often serviced by clearing firms, but fails to realize the amount of work that must be done by the small broker-dealers themselves. FINRA states:

> "Moreover, small firms are more likely to have their customer confirmations generated by clearing firms. To the extent that clearing firms will not pass along the full implementation costs to each introducing firm, small firms may incur lower costs than large firms to comply with the proposed rule change."[7]

FIF members strongly disagree with this statement. While it is up to each individual service provider to determine whether any development costs or ongoing services fees will be allocated to its customers, we must highlight *the significant work that must be done by every broker-dealer*, beyond the work that will be done and services that will be provided by their third party vendors. For example, clearing firms will require their introducing broker clients, and service bureaus will require their self-clearing clients, to provide the prevailing market price ("PMP") (or contemporaneous price) at the point of trade entry and/or later in the trading day; as it is not possible for these service providers to know the value from which the trading firm marked the bonds. They will expect direct input from the trading firm/trader, which will require correspondent/client firms to remediate their systems in ways described in subsequent sections. (See Basic Implementation Requirements, below.) Contrary to FINRA's assumption that there will be minimal impact on small firms, in fact comparatively speaking, the heaviest burden of expense will fall on the small broker-dealers because they currently have limited technology in place that would be capable of identifying associated trades, since there are no current requirements to do so. These firms should however, have procedures in place to determine prevailing market price.

One of the critical underlying issue is the requirement to calculate mark-up/mark-downs based on contemporaneous cost, when triggered by one or more principal trades executed in the same security on the same side, in an amount equal to or greater than the customer trade. FIF must stress that to accomplish this would require a complex series of programs that will disrupt the normal flow of information and existing processes. It would require significant development and be extremely costly to identify the relevant transactions executed either before or after the retail trade subject to the required disclosure.

In terms of the regulatory and/or investor benefits vis-à-vis the associated implementation costs, the filing cites several features of the proposal that are presumed to benefit retail investors; however, these are subjective discussions and the results are not quantitatively measurable. The changes required will be a significant cost to all market participants, and it has not been demonstrated that the added data will cause retail investors to examine their confirmations more often or more closely, nor will the information provided be well understood by some retail customers (e.g. the percent of mark-up/mark-down could be confused with yield).

Cost-Effective Alternative

A more straightforward solution with similar results relies only on the prevailing market price and would not require trade matching or linkages. Based on the statistics provided in FINRA Regulatory Notice 15-36, linked transactions involving multiple trades would occur over a maximum period of 2 hours 82% of the time, and for

[6] https://www.finra.org/sites/default/files/15-36_FIF_comment.pdf; Footnote 6, page 3.
[7] https://www.sec.gov/rules/sro/finra/2016/34-78573.pdf; page 23.

cases involving a single principal trade to match the retail trade, the two trades would occur within 2 hours of each other 98% of the time. Hence, the vast majority of trades that would trigger the requirement would have occurred within a 2-hour period. Whether a related trade occurs within 2 minutes or 2 hours, systems reengineering and extensive programming would be necessary to identify linked trades in order to establish the contemporaneous cost as described in the filing.

Generally, we would not expect significant market movement or change in market prices over the 2-hour period. Absent any announcement that would impact interest rates, or a credit issue with the security, any price changes should be minimal, and resulting calculations from the minor differences between the PMP and the contemporaneous cost will not justify the huge expense of identifying the circumstances that would trigger the requirement and require the use of contemporaneous cost. In fact, in the opinion of FIF members, intraday price swings would warrant the use of PMP rather than contemporaneous price, as demonstrated in a later section of this letter.

The filing also mentions that several of the implementation approaches have been suggested by FINRA to leverage existing processes or procedures so as to save expense, e.g. prevailing market price is already required and should be readily available. As previously mentioned, FIF will not comment on the processes or procedures firms must employ to determine the prevailing market price (whether manual or automated), or the suitability of the PMP for these purposes; however, FIF's recommended alternative to referencing contemporaneous cost is to rely on prevailing market price in all instances.

Recommended Process Flow

It is FIF's understanding that under the rule, firms are permitted to apply the mark-up/mark-down calculations to PMP, and include the dollar amount and percentage to "all" confirmations, or to "all retail" confirmations. This approach would allow firms to continue using existing straight through processing (STP) confirmation processes; although significant changes would be required including support for new data, calculations and reformatting confirmations.

Firms' concerns with the complexities of the "look-through" requirements[8] would also be alleviated using the FIF alternative, as PMP and the required calculations will be applied to all (retail) confirmations regardless of their origins. This also should not result in more cancelations and corrections of confirmations, unless for some reason the PMP is not available at the time the confirmation is being generated; in which case, end-of-day exception processing would need to be put in place to identify trades missing the PMP, and send out a revised confirmation[9].

Generally, firms' implementations will be quite customized and must ultimately be driven by the complexity of a firm's organization, business model, principal trading practices, desk relationships (e.g. affiliates, arms-length transactions, information barriers), existing technology environment, as well as customer expectations.

[8] FIF members do appreciate the exceptions made in the rule proposal to the "look-through" requirement where firms "have in place policies and procedures reasonably designed to ensure that the functionally separate principal trading desk through which the member purchase or member sale was executed had no knowledge of the customer transaction." https://www.sec.gov/rules/sro/finra/2016/34-78573.pdf; page 8.

[9] Please note that any adjustments to a PMP and./or resulting changes to the dollar amount or percentage of the mark-up/mark-down should not require a new confirmation to be generated.

Intraday Price Changes Warrant Use of Prevailing Market Price (PMP)

The proposed rule describes FINRA's expectations with respect to the calculation of the mark-up/mark-down; specifically, FINRA references:

> "Rule 2121 and Supplementary Material .02 which provides extensive guidance on how to calculate the mark-up for the fixed income securities to which the proposal would apply, including a presumption to use contemporaneous cost or proceeds." [10]
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> "To the extent that a member will often use its contemporaneous cost or proceeds, e.g., the price it paid or received for the bond, as the prevailing market price for purposes of calculating the mark-up or mark-down, FINRA believes that limiting the disclosure to those instances where there is an offsetting trade in the same trading day will reduce the variability of the mark-up and mark-down calculation." [11]

There is great concern among the broker-dealers that intra-day price swings could be misleading when calculations are applied to a set of associated trades using a combination of both Prevailing Market Price (PMP) and contemporaneous cost. As previously mentioned, in better than 82% of cases where there is more than one trade that could trigger the disclosure requirement, the trades occur within 2-hours of each other. FIF contends it is unlikely that there would be significant price change during the 2-hour period; hence, the prevailing market price at the time of trade will be extremely close to the contemporaneous cost. There could be a greater chance of price change where related transactions exceed the 2-hour window; however, FIF members believe that in any case, use of the PMP rather than the contemporaneous cost will more accurately reflect the mark-up from the actual value of the security at the time the transaction took place. The example below illustrates one scenario (one of the 18% exception) where firms would not want to base the mark-up/mark-down calculations on contemporaneous cost, as PMP provides a more realistic view of the market.

9:00 AM – Broker-dealer purchases 100 bonds at par.
9:01 AM – Broker-dealer sells 50 bonds to a retail investor at 101, including 1 pt. sales credit and no P&L.
1:00 PM – Fed signals future rate reduction and the fixed income market climbs (prices rise as interest rates decline).
3:30 PM – Broker-dealer sells 50 bonds to a retail investor at 103, including 1. pt. sales credit. The market reflects other interdealer transactions in the same security going off at 102, so the PMP at the time of trade becomes/is 102 (versus contemporaneous cost of par).

The difference between the broker-dealer's contemporaneous cost at par and the subsequent sale of 50 bonds to the retail investor at 103 is 3%; however, over the course of the day the PMP moved from 100 to 102. If a firm uses contemporaneous cost as the prevailing market price, then the confirmation mark-up disclosure requirements would indicate the bond is marked up 3%.

Given the above scenario and similar circumstances, if firms were to apply the approach proposed in the rule filing, a back-end check is necessary to determine if a new PMP would be needed where interest rates or credit spreads have changed from the time of the original Trading Desk transaction to the time of the client transaction. This would require a set of complex procedures involving market monitoring and exception processing (e.g. apply end-of-day checks to validate PMP and then integrate the new PMP into systems calculations same day before client confirms can be run in a nightly batch). This will be completely avoided if the FIF Proposed Alternative is utilized instead.

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[10] Ibid. page 10.
[11] Ibid. page 5.

Therefore, FIF recommends that *the mark-up/mark-down should be calculated 100% of the time from PMP, which should be extremely close to the contemporaneous cost at least 82% of the time.* This approach will produce more consistent results, and avoid unnecessary complexity that provides no additional benefit to the regulators or to the customers.

Basic Implementation Requirements

Generally, whether or not broker-dealers rely on third party services or their own proprietary platforms, each broker-dealer will need to remediate their workflows, systems and interfaces. The following areas must be addressed to implement the basic requirements using PMP applied to all (retail) confirmations. The requirement to establish contemporaneous cost triggered by a transaction that occurs either prior to or after the retail trade, will require a complex series of programs that will disrupt the normal flow of information and existing processes. A process to identify related trades in order to obtain contemporaneous cost is not considered here, as FIF members have not yet determined how to solve those challenges, and we hope the regulators will heed our caution and concerns regarding the complexity, costs, risks and time it would take to implement any potential solutions.

- All broker-dealer firms will need to alter their work flow and train personnel to a) capture the PMP; and b) identify a related trade to establish a contemporaneous price.
- Policies and procedures, operational procedures and supervisory procedures must all be amended to reflect the revised processes to identify impacted trades, establish the PMP or contemporaneous price, calculate differences, etc.
- Firms' proprietary trade entry front-ends, as well as OMS/EMS vendors' applications and trading platforms will need to be modified to support new fields and functionality needed to enter additional information, both at the time of trade as well as later in the day on trades previously executed. This information must be passed through to downstream systems, including internal and external applications. New messaging feeds will need to be developed to facilitate the information exchange.
- Fields must be included in the data warehouse to store the additional information being supplied to retail customers.
- Firms may perform their own price difference and percentage calculations (or rely on third parties to calculate) and apply as the confirmation is being generated.
- Back-end service providers including clearing firms, securities processing service bureaus or confirmation providers must be ready to receive and process new fields of information, and may be expected to derive price difference and percentage calculations.
- Confirmations must be reformatted to provide the additional data in a manner that is easy to read and will not further confuse retail investors. Definitions of new fields must also be provided in some form or format. Note there are additional modifications necessary for electronic confirms facilitated by Omgeo, FIX or other middle office solutions.

Future Requirements

TRACE-Eligible Securities

FIF members also question whether there are plans to broaden the scope of the fixed income securities to fall under the regulation. While TRACE-eligible mortgage-backed securities, TBAs, or asset-backed securities are not currently included in the rule proposal, over what period of time are they expected to be added? As Treasuries have also been proposed for TRACE reporting, will Treasury securities be included as well?

Furthermore, FIF members are concerned that there could be differences in information that is TRACE-reported vs. that which is provided on a confirmation. For example, a "no-remuneration" flag is now required on a TRACE report, but a mark-up/mark-down based on differences between purchase/sale price and PMP or contemporaneous cost could be interpreted as remuneration. FIF members look for clear guidance on this issue.

Time of Execution and Links to TRACE

The proposal indicates that FINRA intends to submit a rule filing in the near future to require firms to provide the time of the trade on customer confirmations, as well as a link to TRACE.

In our previous comment letter, FIF expressed concern in placing the Time of Execution on the confirmation for two primary reasons: 1) it will be an additional expense to parse that information from trading platforms, as this is not typically carried through to the back office systems that generate the confirmations; and, 2) it will not be possible to adjust the Time of Execution properly in conjunction with any trade modifications, cancelations or corrections.[12]

Additionally, the original intent in requesting the Time of Execution on the trade confirmation was to support the investors' ability to look up the prices of similar trades on the regulator's website. We also remind FINRA that FIF's original support for including a link to TRACE was in lieu of providing a reference price. Firms under this rule proposal are now required to provide the PMP or contemporaneous cost, thus there is no longer a need to provide either the Time of Execution or the link to the specific security. In fact, adding a link to a set of prices that differs from that upon which the mark-up/mark-down has been calculated (particularly if it is contemporaneous cost and not the current PMP), will cause further confusion.

Furthermore, we note that where a block trade is allocated to sub-accounts, confirmations are sent to the sub-accounts. The time of execution on the confirmation would be based on the time at which the terms of the trade were agreed, at the block level. Any investor (sub-account) who looks for his/her trade on the TRACE website based on time of execution and quantity will not locate their specific trade, as the trade was TRACE-reported at the block level.

The MSRB proposal has included the requirement to place the CUSIP-specific URL on the customer confirmation, and FINRA has indicated a similar requirement will be proposed in the near future. As highlighted in our previous comment letter, it will be difficult for firms to coordinate with FINRA and MSRB to maintain the exact URL that will link to the specific CUSIP purchased or sold by the customer. If the link is not specific to the security and merely identifies the landing page for TRACE or EMMA price reporting, it will not be particularly helpful to the investor, and will occupy precious real estate on an already overpopulated confirmation.

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[12] https://www.finra.org/sites/default/files/15-36_FIF_comment.pdf; page 5.

Our members also note that the large majority of retail investors receive paper confirmation. Because it is not possible for the retail investor to click on a hyperlink provided on a paper confirmation, the URL would need to manually entered into a browser in order to access the TRACE or the EMMA websites. It is unlikely an investor would go to the trouble, given the length of the URL that would be entered. Following is an example: http://emma.msrb.org/SecurityView/SecurityDetails.aspx?cusip=160075vv6.

Conclusion

FIF wishes to thank the SEC and FINRA for providing the opportunity to comment on this proposed rule to require mark-up/mark-down disclosures on certain customers' fixed income trade confirmations. We reiterate the implications for implementing these regulatory requirements are broad and deep, and we are hopeful that the challenges of this initiative will be seriously considered by the regulators in establishing a **realistic timeframe for implementation** and effective date for compliance.

Equally important, the industry is in the process of examining the MSRB proposal to identify similarities and differences in the two proposals. FIF does plan to submit comments on the MSRB proposal to discuss implementation requirements and recommendations, and to stress **regulatory harmonization**. We hope the Commission and FINRA will consider any additional comments FIF may direct in connection with both the MSRB and the FINRA proposal, as we remind the regulators of the importance in maintaining complete alignment in the rules to ensure uniform processes may be applied to all impacted fixed income securities.

We are eager for feedback on our concerns and our recommendations, particularly regarding **consistent use of Prevailing Market Price**, and efforts to reduce the level of complexity involved in implementing the proposed rules.

Please do not hesitate to contact me to arrange for further discussion on these critical issues.

Regards,

Mary Lou Von Kaenel

Mary Lou Von Kaenel
Managing Director
Financial Information Forum