Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. 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–Phlx–2016–83, and should be submitted on or before September 9, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[24]

Robert W. Errett,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–78573; File No. SR–FINRA–2016–032]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a 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

August 15, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'' or ''SEA'') [1] and Rule 19b–4 thereunder,[2] notice is hereby given that on August 12, 2016, Financial Industry Regulatory Authority, Inc. (''FINRA'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA 2232 (Customer Confirmations) to require members to disclose additional pricing information on retail customer confirmations relating to transactions in fixed income securities.

The text of the proposed rule change is available on FINRA's Web site at *http://www.finra.org,* at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

FINRA is proposing to amend Rule 2232 to require members to provide additional pricing information on customer confirmations in connection with non-municipal fixed income transactions with retail customers. Specifically, if a member trades as principal with a non-institutional customer in a corporate debt or agency debt security, the member must disclose the member's mark-up or mark-down from the prevailing market price for the security on the customer confirmation, if the member also executes one or more offsetting principal transaction(s) on the same trading day on the same side as the customer trade, the aggregate size of which meets or exceeds the size of the customer trade.

While members are already required, pursuant to SEA Rule 10b–10, to provide customers with pricing information, including transaction cost information, in connection with transactions in equity securities where the member acted as principal, no comparable requirement currently exists for transactions in fixed income securities.[3] Based on statistics that are discussed in greater detail below, FINRA believes that some customers pay materially higher mark-ups or mark-downs in retail size trades than other customers for the same fixed income security. FINRA believes that the proposed requirement will provide meaningful and useful pricing information to retail customers in fixed income securities. FINRA believes that the proposal will better enable customers to evaluate the cost and quality of the execution service that members provide, will promote transparency into firms' pricing practices, and will encourage communications between firms and their customers about the pricing of their fixed income transactions.

As described in greater detail in Item II.C. below, FINRA initially solicited comment on a related proposal in *Regulatory Notice* 14–52 (''initial proposal''),[4] and subsequently on a revised proposal in *Regulatory Notice* 15–36 (''revised proposal'').[5] FINRA also has been working with the MSRB to develop similar proposals, as appropriate, to ensure consistent disclosures to customers across debt securities and to reduce the operational burdens for firms that trade multiple fixed income securities. As such, the MSRB has been developing its own pricing information disclosure proposal, and FINRA and the MSRB published their initial and revised proposals concurrently.[6] FINRA understands that the MSRB intends to file a substantially similar rule change.

Provided below is a more detailed description of each aspect of the proposed rule change.

Scope of the Disclosure Requirement

The proposed rule applies where the member buys (or sells) a security on a principal basis from (or to) a non-institutional customer and engages in one or more offsetting principal trades on the same trading day in the same security, where the size of the member's offsetting principal trade(s), in the aggregate, equals or exceeds the size of the customer trade. A non-institutional customer is a customer account that is not an institutional account, as defined

[24] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* 17 CFR 240.10b–10. Under Rule 10b–10, where a member is acting as principal for its own account and is not a market maker in an equity security, and receives a customer order in that equity security that it executes by means of a principal trade to offset the contemporaneous trade with the customer, the rule requires the member to disclose the difference between the price to the customer and the dealer's contemporaneous purchase (for customer purchases) or sale price (for customer sales). *See* Rule 10b–10(a)(2)(ii)(A). Where the firm acts as principal for any other transaction in an NMS stock, or an equity security that is listed on a national securities exchange and is subject to last sale reporting, the rule requires the member to report the reported trade price, the price to the customer in the transaction, and the difference, if any, between the reported trade price and the price to the customer. *See* Rule 10b–10(a)(2)(ii)(B).

[4] *See Regulatory Notice* 14–52 (November 2014).

[5] *See Regulatory Notice* 15–36 (October 2015).

[6] *See* MSRB Regulatory Notice 2015–16 (September 2015), MSRB Regulatory Notice 2014–20 (November 2014).

in Rule 4512(c).[7] In addition, the proposed rule applies only to transactions in corporate debt securities, as defined in the proposed rule,[8] and agency debt securities, as defined in Rule 6710(l).[9]

FINRA believes that the proposed rule provides meaningful pricing information to individual investors that would most benefit from such disclosure, while not imposing unduly burdensome disclosure requirements on members. FINRA believes that requiring disclosure for retail customers, *i.e.,* accounts that are not institutional accounts, is appropriate because retail customers typically have less ready access to market and pricing information than institutional customers. FINRA believes that using the definition of an institutional account as set forth in Rule 4512(c) to define the scope of the proposal is appropriate because firms use this definition in other rule contexts, therefore reducing the implementation costs associated with this proposal.[10]

Same Day Triggering Timeframe

FINRA believes that it is appropriate to require disclosure of the mark-up or mark-down where the firm's offsetting principal trade(s) equaled or exceeded the size of the customer trade on the same trading day. 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.

As is discussed in greater detail in Item II.C., a number of commenters stated that the window for triggering disclosure should be limited to two hours. Among other things, commenters argued that a two-hour window would be easier to implement, and would more closely capture riskless principal trades, which would align the proposed disclosure to the riskless principal disclosure requirements for equity securities under Rule 10b–10.

As is also discussed below, FINRA has generated statistics, based on trade data reported to the Trade Reporting and Compliance Engine (''TRACE''), that indicate that the majority of firm principal/customer trades that occur within the same trading day occur within thirty minutes of one another. Nonetheless, FINRA believes that there are added benefits to requiring disclosure for trades that occur within the same trading day, rather than only trades that occur within two hours. First, the full-day window will ensure that more investors receive mark-up or mark-down disclosure, even where their trades occur more than two-hours from the firm principal trade (but still occur on the same trading day). Second, the full-day window may make members less likely to alter their trading patterns in response to the proposed rule, as members would be required to hold positions overnight to avoid the proposed disclosure.[11] Finally, as is discussed further below, TRACE data for 3Q15 shows a material difference between the median mark-up/mark-down and the mark-ups/mark-downs at the tail of the distribution, indicating that some customers (those at the tail of the distribution) paid considerably more than others (at the median of the distribution). This data indicates that there is variability in the difference in prices paid in both firm principal and customer trades that occurred close in time to one another, *e.g.,* within 30 minutes, and in firm principal and customer trades that did not occur close in time to one another. Based on this data, FINRA believes that the proposed disclosure would provide valuable information for customers whose trades occurred on the same trading day as the firm principal trade, regardless of whether those trades occurred close in time.

Some commenters recommended that FINRA limit the disclosure obligation to riskless principal transactions involving retail investors, as this would more accurately reflect dealer compensation and transaction costs, and would be more consistent with the stated objectives of the SEC in this area. These commenters would apply the proposed rule to riskless principal transactions as previously defined in the equity context by the Commission, where the broker-dealer has an ''order in hand'' at the time of execution. However, FINRA believes that it may be difficult to objectively define, implement and monitor a riskless principal trigger standard for fixed income securities and also believes that using the riskless principal standard ultimately is too narrow and that customers will benefit from the disclosure irrespective of whether the firm's capacity on the transaction was riskless principal.

Non-Arms-Length Affiliate Transactions

With respect to the offsetting principal trade(s), where a member buys from, or sells to, certain affiliates, the proposal would require the member to ''look through'' the member's transaction with the affiliate to the affiliate's transaction with a third party in determining when the security was acquired and whether the ''same trading day'' requirement has been triggered. Specifically, FINRA proposes to require members to apply the ''look through'' where a member's transaction with its affiliate was not at arms-length. For

[7] Rule 4512(c) defines 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.''

[8] The proposed rule defines 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 Rule 6710(o) or an Asset-Backed Security as defined in Rule 6710(cc).''

[9] 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.'' To make the proposed changes to Rule 2232 applicable to agency debt securities, as part of this proposal, FINRA will amend Rule 0150 to add Rule 2232 to the list of FINRA rules that apply to ''exempted securities,'' except municipal securities.

[10] As discussed in greater detail below, FINRA initially proposed that the disclosure requirement would apply to customer trades of a ''qualifying size,'' which was defined as customer transactions involving 100 bonds or less or bonds with a face amount of $100,000 or less, based on reported quantity. In response to comments that the proposed size-based standard could either exclude retail customer transactions above that amount from the proposed disclosure, or subject institutional transactions below that amount to the proposed disclosure, FINRA revised the proposal to incorporate the Rule 4512(c) definition of an institutional account.

[11] It is important to note that, under Rule 5310 (Best Execution and Interpositioning), members must 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. Supplementary Material .01 to Rule 5310 further emphasizes that a member must make every effort to execute a marketable customer order that it receives fully and promptly. Any intentional delay of a customer execution to avoid the proposed rule or otherwise would be contrary to these duties to customers. If the proposed rule change is approved, FINRA will monitor trading patterns to ensure firms are not purposely delaying a customer execution to avoid the disclosure. 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, Rule 5310 and Rule 2010 (Standards of Commercial Honor and Principles of Trade).

purposes of the proposed rule change, an ''arms-length transaction'' would be considered a transaction that was conducted through a competitive process in which non-affiliate firms could also participate—*e.g.,* pricing sought from multiple firms, or the posting of multiple bids and offers—and where the affiliate relationship did not influence the price paid or proceeds received by the member. 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. FINRA believes that sourcing liquidity through a non-arms-length transaction with an affiliate is functionally equivalent to selling out of its own inventory for purposes of the proposed disclosure trigger. FINRA therefore believes it is appropriate in those circumstances to require a member to ''look through'' its transaction with its affiliate to the affiliate's transaction with a third party to determine whether the proposed rule applies in these circumstances.[12]

Exceptions for Functionally Separate Trading Desks and Fixed-Price Offerings

The proposed rule also contains two exceptions from the proposed disclosure requirement. First, if the offsetting same day firm principal trade was executed by a trading desk that is functionally separate from the firm's trading desk that executed the transaction with the customer, the principal trade by that separate trading desk would not trigger the disclosure requirement. Firms must 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.[13] FINRA believes that this exception is appropriate because it recognizes the operational cost and complexity that may result in requiring a firm principal trade executed by a separate, unrelated trading desk as the basis for determining whether a mark-up or mark-down disclosure is triggered on the customer confirmation. For example, the exception would allow an institutional desk within a firm to service an institutional customer without necessarily triggering the disclosure requirement for an unrelated trade performed by a separate retail desk within the firm. At the same time, in requiring that the member have policies and procedures in place that are reasonably designed to ensure that the functionally separate principal trading desk had no knowledge of the customer transaction, FINRA believes that the exception is sufficiently rigorous to minimize concerns about the potential misuse of the exception. In other words, in the example above, the firm could not use the functionally separate trading desk exception to avoid the proposed disclosure requirement if trades at the institutional desk were used to source transactions at the retail desk.

FINRA also believes that this exception is appropriate and consistent with the concept of functional and legal separation that exists in connection with other regulatory requirements, such as SEC Regulation SHO, and notes that some members already maintain functionally separate trading desks to comply with these requirements.

Second, the proposed rule would not apply if the member acquired the security in a fixed-price offering and sold the security to non-institutional customers at the same fixed-price offering price on the day the securities were acquired. In a fixed-price offering, the compensation paid to the firm, such as the underwriting fee, is paid for by the issuer and described in the prospectus. Given the availability of information in connection with a fixed-price offering, FINRA believes that the proposed disclosure is not warranted in those instances where the security is sold at the fixed-price offering price.

Proposed Information To Be Disclosed on the Customer Confirmation

If the transaction meets the criteria described above, the member would be required to disclose the member's mark-up or mark-down from the prevailing market price for the security. The mark-up or mark-down would be calculated in compliance with Rule 2121 and the supplementary material thereunder, and would be expressed both as a total dollar amount and as a percentage of the prevailing market price.[14] FINRA believes that it is appropriate to require firms to calculate the mark-up in compliance with Rule 2121, as Supplementary Material .02 to Rule 2121 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. While some commenters noted the operational cost and complexity of implementing a previous iteration of this proposal, FINRA notes that firms are currently subject to Rule 2121 and are required to evaluate the mark-ups that they charge in connection with trades to ensure that they are fair and not excessive.[15] FINRA notes that the proposal does not alter the requirements of Rule 2121, or otherwise intend to modify how firms calculate mark-ups. FINRA recognizes that the determination of the prevailing market price of a particular security may not be identical across firms and FINRA will expect that firms have reasonable policies and procedures in place to calculate the prevailing market price and that such policies and procedures are applied consistently across customers. Although the Supplementary Material to Rule 2121 provides extensive guidance, to the extent that firms have additional interpretive questions on the application of Rule 2121 to specific scenarios, FINRA will issue additional guidance as necessary.

[12] Similarly, 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 or mark-down pursuant to Rule 2121 (Fair Prices and Commissions).

[13] This exception is distinguished from the ''look through'' provision noted above, whereby the customer transaction is being sourced through a non-arms-length transaction with the affiliate. Under the separate trading desk exception, functionally separate trading desks are required to have policies and procedures in place that are reasonably designed to ensure that trades on the functionally separate desks are executed with no knowledge of each other and reflect unrelated trading decisions. Additionally, FINRA notes that this exception would only apply to determine whether or not the proposed disclosure requirement has been triggered; it does not change a member's existing requirements relating to the calculation of its mark-up or mark-down under Rule 2121.

[14] FINRA and the MSRB conducted investor testing which indicated that investors found that disclosing the mark-up or mark-down both as a dollar amount and as a percentage of the prevailing market price would be more useful than only disclosing it in one of those forms. FINRA and the MSRB also solicited comment on whether to require members to disclose additional information on the trade confirmation for trades with retail customers, including whether firms should provide a link to TRACE, and whether firms should disclose the time of the customer trade. In response to comments received and support based on investor testing, FINRA intends to submit a rule filing in the near future that proposes these requirements.

[15] Because the proposed mark-up disclosure is not triggered unless an offsetting principal trade occurred on the same day, FINRA anticipates that the number of customer trades that will use a price other than the price of a contemporaneous trade as the prevailing market price are small. Using 3Q15 data, of the retail-size customer trades that have an offsetting firm principal trade on the same trading day, over 83 percent of those trades occurred within 30 minutes of each other. In 10.5 percent of these instances, an intervening trade, either by the same firm or a different market participant, occurred. Given the close time proximity between the majority of firm principal and customer trades, and the fact that most of these trades did not have an intervening trade, firms will typically use their contemporaneous cost as the prevailing market price.

FINRA believes that the proposal will provide retail customers with several important benefits. As discussed above, members are not required to provide customers who buy or sell fixed income securities with the same pricing information regarding mark-ups and mark-downs as customers who buy or sell equity securities. FINRA believes that requiring mark-up/mark-down disclosure will provide retail investors in non-municipal fixed income securities in transactions covered by the rule with comparable information to what retail investors in equity securities currently receive. FINRA believes that this disclosure will better assist fixed income investors in understanding and comparing the transaction costs associated with their purchases and sales.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change no later than 90 days following Commission approval. The effective date will be no later than 365 days following Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[16] which requires, among other things, that FINRA rules must 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,[17] which requires that FINRA rules not impose any burden on competition that is not necessary or appropriate.

FINRA believes that this proposed rule change is consistent with the Act because it will provide retail customers with meaningful and useful additional pricing information that retail customers cannot readily obtain through existing data sources such as TRACE. This belief is supported by investor testing, which indicates that investors find aspects of the proposed requirements useful, including disclosing the mark-up or mark-down both as a dollar amount and as a percentage of the prevailing market price. FINRA believes that some customers pay materially more for trades in fixed income securities than other customers in comparable trades. FINRA believes that the proposed rule will better enable customers to evaluate the cost of the services that members provide by helping customers understand mark-ups or mark-downs from the prevailing market prices in specific transactions. FINRA further believes that this type of information will promote transparency into members' pricing practices and encourage communications between members and their customers about the execution of their fixed income transactions. This proposal also will provide customers with additional information that may assist them in detecting practices that are possibly improper, which would supplement FINRA's own surveillance and enforcement program.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed changes will apply equally to all similarly situated members. Additionally, all members already have an obligation to calculate mark-ups to ensure compliance with Rule 2121.

Economic Impact Assessment

(a) Need for the Rule

FINRA is concerned that retail investors in fixed income securities currently are limited in their ability to understand and compare transaction costs associated with their purchases and sales. Investor testing conducted by FINRA and the MSRB reveals that investors lack a clear understanding of the concepts and definitions of mark-up and mark-down and their role in dealer compensation. The proposed disclosure is expected to provide retail investors with valuable pricing information, encourage investor participation in the fixed income markets, and foster price competition among dealers, which may lower transaction costs for retail transactions in fixed income securities.

The staff's analysis of TRACE data for 3Q15 finds a large difference between the estimated median mark-up/mark-down and the tail of the distribution, indicating that some customers paid considerably more than others in similar trades.[18] For example, for retail size (100 or fewer bonds) investment grade corporate debt transactions in 3Q15, the median estimated mark-up on customer buy orders was 0.53 percent, whereas the 95th percentile was more than four times higher (2.23 percent), suggesting that while the mark-up was half a percent or less on 50 percent of these orders, five percent of the orders (representing approximately 7,000 trades) had mark-ups of more than two percent.[19] Similarly, the median estimated mark-up for retail size corporate debt transactions in high-yield and unrated securities in 3Q15 was 0.83 percent and the 95th percentile was 2.96 percent.

Some market participants suggested that the proposed disclosure might not be meaningful because the observed dispersion in mark-ups might be explained by bond- or execution-specific characteristics. The staff's analysis of TRACE data for 3Q15 does not find relationships between mark-ups and bond- or execution-specific characteristics that would fundamentally undermine the value of the proposed requirement.

Specifically, some market participants asserted that high mark-ups might be adequate compensation for enhanced execution price. For example, it was argued that a dealer might reasonably charge a high mark-up on a customer purchase if the transaction price was lower than the prevailing market price. To examine the relationship between mark-up and price, the staff compared the price of each retail size customer purchase (sale) of a bond to all prices of retail size customer purchases (sales) of the same bond in 3Q15 to measure relative execution price.[20] The analysis

[16] 15 U.S.C. 78*o*–3(b)(6).

[17] 15 U.S.C. 78*o*–3(b)(9).

[18] The mark-up and mark-down calculations involved matching customer trades to offsetting same-day principal trades by the same dealer in the same CUSIP. This included matching same-sized trades as well as trades of different sizes where there was no same-sized match (*e.g.,* a dealer purchase of 100 corporate bonds matched to two sales to customers of 50 corporate bonds each). The mark-ups (mark-downs) on customer buys (sells) correspond to the percentage difference in price in customer trades and the offsetting principal trade. In cases when the offsetting principal trade was also a customer trade, the combined mark-up and mark-down ("spread") on these roundtrip transactions was calculated as the percentage difference in price between the customer buy and the customer sell.

[19] Most matched trades occurred close in time to each other. For example, among mark-up pairs of retail size customer purchases in investment grade corporate bonds in 3Q15, approximately 80 percent of the paired trades occurred within 30 seconds of each other. Nonetheless, the estimated mark-ups and mark-downs were calculated based on matching customer trades to offsetting same-day principal trades by the same dealer in the same CUSIP, and thus may be different from the ones calculated based on the prevailing market price.

[20] The sample only includes customer transactions that can be matched with offsetting same-day principal trades. In addition, the staff notes that the metric of relative execution price would be less reliable if fixed income security prices fluctuated widely within 3Q15. However, the monthly volatility of 10-year Treasury rates in 3Q15 was always below the average level of the prior 10 years, indicating that the interest rate volatility was moderate during the quarter. Treasury securities are considered to be free of default risk, and therefore are commonly used as a reliable interest rate benchmark for a wide range of private market transactions.

finds that higher estimated mark-ups were associated with higher, not lower, purchase prices as compared to all the purchase prices of the same bond in the same quarter. For instance, for retail size customer purchases of investment grade corporate bonds, the trades with the lowest estimated mark-ups (below the fifth percentile) had an average price percentile ranking of 35. In contrast, the trades with the highest estimated mark-ups (above the 95th percentile) had an average price percentile ranking of 63.

Some market participants asserted that high mark-ups and mark-downs might be caused by exceptionally low transaction quantities. For example, it was argued that a high mark-up on a customer purchase order of only three bonds might be justified by the high search cost. The analysis of TRACE data for 3Q15 finds no evidence that the highest estimated mark-ups were associated with unusually low quantities. For instance, for retail size customer purchases of investment grade corporate bonds, the median quantity of the trades with the highest estimated mark-ups (above the 95th percentile) was 20 bonds. Moreover, the median quantity did not change much for trades with different estimated mark-up levels.[21]

As discussed above, the mark-up and mark-down estimation involves matching same-sized trades as well as trades of different sizes where there was no same-sized match (*e.g.,* a dealer purchase of 100 corporate bonds matched to two sales to customers of 50 corporate bonds each). Some market participants asserted that the practice of breaking down a large transaction into smaller offsetting customer trades might lead to lower mark-ups due to the economies of scale, and thus might help explain the observed dispersion in mark-ups. The analysis of TRACE data for 3Q15 finds that splitting a larger principal trade into multiple smaller offsetting customer trades was associated with higher, not lower, mark-ups.

The analysis of TRACE data for 3Q15 also shows that the observed differences in estimated mark-ups were unlikely to be solely driven by bond characteristics. The results for retail size customer purchases of investment grade corporate bonds serve as an example. Among the bonds that had the highest estimated mark-ups (above the 95th percentile), approximately 77 percent also had trades with estimated mark-ups below the median. Moreover, these 77 percent of bonds traded more frequently with estimated below-median mark-ups. Further, the staff's analysis finds that bonds with higher trading frequencies in 3Q15, and presumably higher liquidity, had higher estimated mark-ups.[22]

In conclusion, the observed large dispersion in mark-ups and mark-downs do not appear to principally reflect bond or execution characteristics. The proposed disclosure is expected to provide customers with valuable and consistent information to understand, compare and evaluate transaction costs associated with their trades.

(b) Economic Baseline

The proposal would impact broker-dealers in the retail market of corporate and agency debt securities by imposing confirmation disclosure requirements on certain customer transactions. In 3Q15, the average daily number of retail size customer trades was 18,330 in corporate debt securities and 676 in agency debt securities. The transactions were mainly concentrated among large firms. For example, the top 20 broker-dealers with the highest volumes accounted for roughly 70 percent of the transactions for both corporate and agency debt securities.

It is estimated that approximately 59 percent of the retail size customer trades in corporate debt securities in 3Q15 would have been subject to the disclosure requirement if the proposed rule had been in place.[23] These disclosure-eligible trades were reported by about 800 dealers but were concentrated among large dealers. As discussed above, dealers already have an obligation to calculate their mark-ups for principal transactions in non-municipal fixed income securities to ensure compliance with Rule 2121.

(c) Economic Impacts

(i) Benefits

FINRA believes that the proposal will provide retail customers with meaningful and useful pricing information that these customers cannot readily obtain through TRACE data. As evidenced by investor testing, investors consider it important to know how much firms charge for transactions in fixed income securities, yet they are unfamiliar with mark-ups and mark-downs. FINRA believes that the pricing information will better enable customers to evaluate the cost and quality of the services that members provide by helping customers understand mark-ups or mark-downs from the prevailing market prices in specific transactions. FINRA further believes that this type of information will promote transparency into members' pricing practices and encourage communications between members and their customers about the pricing of their fixed income transactions. By providing additional pricing information to customers, this proposal may encourage customers to seek out other dealers that might offer more competitive prices for the services offered, which may incentivize members to offer more competitive prices to their retail customers. Any resulting reduction in the differential between the prevailing market price and the price paid by the customer would reduce transaction costs paid by investors and enhance investor confidence in the alignment between transaction costs and the value of the services received, which may encourage wider participation by investors in the retail segments of the corporate and agency debt market.[24]

(ii) Costs

FINRA recognizes that the proposal would impose burdens and costs on members. In both *Regulatory Notices* 14–52 and 15–36, FINRA specifically solicited comment on the potential costs of the proposal to members.[25] For example, in *Regulatory Notice* 15–36, FINRA asked about the anticipated costs to firms in developing and implementing systems to comply with the revised proposal and the anticipated on-going costs associated with the revised proposal. FINRA asked members to provide the estimates of these costs, and the assumptions underlying those estimates. While commenters stated that the initial and the revised proposals would impose significant implementation costs on firms, no commenters provided specific cost

[21] The median quantity was 28 bonds for trades with mark-ups below the fifth percentile, 15 bonds for trades with mark-ups between the 25th and 50th percentiles, and 20 bonds for trades with mark-ups between the fifth and 10th percentiles, the 10th and 25th percentiles, the 50th and 75th percentiles, the 75th and 90th percentiles, and the 90th and 95th percentiles.

[22] The analysis also finds a negative but limited impact of credit rating on the level of mark-ups.

[23] The percentage of eligible transactions may be overestimated as some matched trades may be transactions with affiliates or other trading desks.

[24] FINRA notes that this proposal may also provide regulatory benefits, as disclosing additional pricing information to customers may assist them in detecting practices that are possibly improper, which would supplement FINRA's own surveillance and enforcement program.

[25] *Regulatory Notices* 14–52 and 15–36 proposed to require members to disclose a ''reference price,'' while this proposal requires mark-up disclosure, as determined from the prevailing market price. As discussed below, requiring mark-up disclosure rather than reference price disclosure may result in lower compliance costs.

estimates or a framework to assess anticipated costs.

Among other things, the proposal would require members to develop and deploy a methodology to satisfy the disclosure requirement, identify trades subject to the disclosure, convey the mark-up on the customer confirmation, and adopt policies and procedures to track and ensure compliance with the requirement. To apply the ''look through'' to non-arms-length transactions with affiliates, members would also need to obtain the price paid or proceeds received and the time of the affiliate's trade with the third party. FINRA is also aware, however, that some members already provide a form of mark-up disclosure for their customers, and may therefore incur fewer costs in complying with the proposed disclosure requirement.

The proposal would require firms to examine transactions occurring both before and after a customer trade execution to determine whether the trade is subject to the disclosure requirement. FINRA recognizes that the forward-looking approach (comparison to trades occurring after customer trades) may be difficult to implement in some current confirmation processing systems. Some firms with such systems stated that they would need to both maintain the current systems and build entirely new systems to comply with the proposed rule change. The operational impact of the proposal would be more material to these firms.

(iii) Effect on Competition

FINRA believes that the proposal would improve price transparency, enhance investor confidence, and promote price competition among dealers in the retail market of corporate and agency debt securities. Increased participation by retail investors and competitive pressure may lead to lower transaction costs.

In response to *Regulatory Notices* 14–52 and 15–36, some commenters stated that the costs associated with increased pricing disclosure may lead some dealers to exit the retail market. Some commenters noted that the requirement to disclose pricing information if the firm principal trade and the customer trade occurred on the same trading day would disproportionately impact smaller firms, as larger firms would be more able to hold positions overnight and not trigger the proposed requirement.

For each dealer's retail size customer trades in corporate bonds in 3Q15, the staff estimated the percentage of trades with offsetting same-day principal transactions. While large firms had a lower average percentage of matched trades than small firms, the difference appeared to be much greater between firms that were more active in the retail corporate bond market and firms that were less active.[26] For example, for the top 20 firms that are most active in the retail corporate bond market (as measured by the total number of retail size customer trades in principal capacity in the corporate bond market in 3Q15), on average 52 percent of the trades made by those firms qualified as matched trades.[27] In contrast, the average percentage of matched trades was 88 percent for all other firms. Therefore, it is possible that large firms and firms that are more active in the retail corporate bond market have greater capacity to hold inventory and source retail trades from that inventory, and therefore are less likely to trigger the proposed disclosure requirement.

Large firms and firms that are more active in the retail corporate bond market may respond to this proposal differently than other firms. Market participants indicated to FINRA that the costs to altering the trade processing and reporting systems for instances where the triggering principal trade occurred after the customer trade would be substantial. FINRA anticipates that large and more active firms are more likely to provide the disclosure to all retail customers even where a triggering principal trade has not occurred at the time of the customer trade because it would likely be less expensive than other methods of ensuring compliance with the proposed rule. FINRA understands that it is unlikely for less active firms to trade with a retail customer without an offsetting transaction. In the cases that they do, they may choose not to provide the disclosure to all retail customers, but then incur the costs of providing the trade processing information at the end of the day, cancelling and correcting the confirmation trade report at the end of the day for any retail trade that subsequently met the reporting requirements of the proposed rule. It is also possible that firms may choose to avoid entering into any trade that would subsequently trigger a reporting obligation, *e.g.,* by holding a position overnight.

More generally, FINRA understands that some firms are considering providing the mark-up/mark-down disclosure on all retail trades, regardless of whether the dealers' offsetting trade is made within the same day or not. Similarly, some firms have proposed to provide mark-up/mark-down disclosure on both retail and non-retail transactions to lower the costs associated with identifying disclosure-eligible trades. Providing any additional disclosure would be voluntary to firms, and would likely only occur where the benefits, including reduced implementation costs, outweighed the costs imposed. For example, a firm that voluntarily provides disclosure on all retail principal transactions (regardless of whether there was an offsetting transaction on the same trading day) would be able to avoid the forward-looking aspect of the proposal and its associated costs. As well, providing additional disclosures may limit the differential impact on smaller firms. And, as discussed above, FINRA notes that any intentional delay of a customer execution to avoid the proposed rule would be contrary to a firm's duties to customers under Rules 2010 and 5310. If the proposed rule is approved, FINRA will monitor trading patterns to ensure firms are not purposely delaying a customer execution to avoid the disclosure.

The staff also analyzed TRACE data for 3Q15 to understand the relationship between mark-ups and firm characteristics. The analysis finds that large firms and firms that are more active in the retail corporate bond market tend not to be represented within the tail of the largest estimated mark-ups and mark-downs in the distribution in the sample examined. For example, large firms accounted for 85 percent of all retail size customer purchases of investment grade corporate bonds in 3Q15, but only 61 percent of the trades with the highest estimated mark-ups (above the 95th percentile).[28] Similarly, the top 20 firms as measured by the total number of retail size customer trades in principal capacity in the corporate bond market in 3Q15 accounted for 68 percent of all retail size customer purchases of investment grade corporate bonds in 3Q15, but only 28 percent of the trades with the highest estimated mark-ups. These relationships remain significant after controlling for bond and execution characteristics. To

[26] FINRA considers firms with 150 or fewer registered representatives as small firms and 500 or more as large firms. The average percentage of matched retail size customer transactions of corporate bonds in 3Q15 was 89 percent for small firms and 82 percent for large firms. The difference was statistically significant. While the most active firms in the retail corporate bond market tend to be large, well-known firms, there are exceptions.

[27] As retail transactions are proxied by trades of 100 bonds or less, some retail size trades by the more active firms may be institutional transactions.

[28] The sample only includes customer transactions that can be matched with offsetting same-day principal trades.

the extent that the proposed disclosure may lead to changes in investor and firm behaviors, it can logically be anticipated to have a greater impact on firms currently charging relatively high mark-ups and mark-downs. Therefore, the analysis implies that the associated economic costs may be higher to some small firms and firms less active in retail customer trades.

However, it is important to note that small firms tend to be overrepresented within both the tail of the highest and the tail of the lowest mark-ups and mark-downs in the sample examined. In other words, while a disproportionate number of small firms charged relatively high mark-ups, there were also a disproportionate number of small firms that charged relatively low mark-ups. For example, small firms accounted for 8 percent of all retail size customer purchases of investment grade corporate bonds in 3Q15, but 18 percent of the trades with the lowest estimated mark-ups (below the 5th percentile). This implies that some small firms offering competitive prices may benefit from the proposed disclosure.

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.

Therefore, while it is possible that the costs associated with the proposal may lead small dealers to consolidate with large dealers or to exit the market, the effect may be limited. FINRA recognizes that increased concentration in the retail market for fixed income transactions could impact retail costs, by either increasing or decreasing those costs. FINRA also recognizes the potential for members to shift some of the compliance costs on to customers.

(iv) Other Considerations

As initially proposed, FINRA would have required members to disclose a ''reference price,'' which used a baseline that is derived from the price that was actually paid by the firm for the bond that same day, and the differential between that reference price and the price to the customer. In response to both the initial proposal and the revised proposal, commenters raised concerns about the usefulness of reference price disclosure, and the potential burdens associated with implementing such disclosure. Based on concerns raised by commenters about the potential burdens associated with reference price disclosure, FINRA is now amending the proposal to require mark-up disclosure, as determined from the prevailing market price. FINRA believes that requiring mark-up disclosure rather than reference price disclosure may result in lower compliance costs, as members are already required under Rule 2121 to ensure that mark-ups and mark-downs are fair, and therefore should be calculating mark-ups to ensure compliance with Rule 2121. While FINRA notes that some members may generate customer confirmations on an intra-day basis, FINRA notes that the mark-up on the customer trade should generally be established at the time of that trade, which should reduce the impact of this proposal upon the confirmation generation process. While firms may still need to delay confirmation generation until the end of the day for at least some portion of disclosure-eligible trades due to the forward-looking aspect of the proposal, FINRA again notes that firms that voluntarily choose to provide disclosure on all retail trades could continue to provide confirmations intra-day, as the forward-looking aspect of the proposal would no longer be relevant.

FINRA recognizes that the determination of the prevailing market price may not be identical across firms and thus may result in a lack of comparability or consistency in disclosures, especially for thinly traded securities. FINRA expects that firms have reasonable policies and procedures in place to calculate the prevailing market price in a manner consistent with Rule 2121 and that such policies and procedures are applied consistently across customers.

FINRA believes that requiring disclosure for non-institutional accounts may lessen some of the costs and complexity associated with this proposal by allowing firms to use an existing distinction that already is integrated into their operations.

(d) Alternatives Considered

As discussed above and below, FINRA considered several alternative approaches and modified the proposal to reduce potential burdens and costs on member firms. For example, FINRA had proposed the disclosure of a ''reference price,'' but then amended the proposal to require the disclosure of the mark-up or mark-down from the prevailing market price. Similarly, a ''qualifying size'' requirement was replaced with an exclusion for transactions that involve an institutional account. In response to comments and concerns, FINRA also proposes to exclude from the proposed disclosure those transactions which are part of fixed-price offerings on their first trading day and which are sold at the fixed-price offering price, and firm-side transactions that are conducted by a department or desk that is functionally separate from the retail-side desk. Where the member's principal trade was executed with an affiliate of the member in a transaction that was not at arms-length, FINRA proposes to require a member to ''look through'' its trade with the affiliate to the affiliate's trade with the third party to determine whether disclosure is required.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

This proposal was published for comment in *Regulatory Notice* 14–52 (November 2014) and *Regulatory Notice* 15–36 (October 2015). Thirty-two comments were received in response to *Regulatory Notice* 14–52,[29] and eighteen

[29] *See* Letter from Michael Nicholas, CEO, Bond Dealers of America, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''BDA Letter I''); letter from John T. Macklin, Director of Operations, Brean Capital, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''Brean Letter''); letter from Richard Bryant, President, Capital Investment Group, to Marcia E. Asquith, Corporate Secretary, FINRA, dated August 4, 2015 (''CIG Letter''); letter from Micah Hauptman, Financial Services Counsel, Consumer Federation of America, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''CFA Letter I''); letter from Chris Melton, Executive Vice President, Coastal Securities, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 16, 2015 (''Coastal Securities Letter I''); letter from Michael S. Nichols, Principal, Cutter Advisors Group, dated December 5, 2014 (''Cutter Letter''); letter from Larry E. Fondren, President and CEO, DelphX LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 7, 2015 (''DelphX Letter''); Letter from Herbert Diamant, President, Diamant Investments Corp., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 9, 2015 (''Diamant Letter I''); letter from Robert A. Eder, to Cynthia Friedlander, FINRA, dated December 30, 2014 (''Eder Letter I''); letter from Robert A. Eder, dated April 1, 2015 (''Eder Letter II); letter from Norman L. Ashkenas, CCO, Fidelity Brokerage Services LLC and Richard J. O'Brien, CCO, National Financial Services, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''Fidelity Letter I''); letter from Darren Wasney, Program Manager, Financial Information Forum, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''FIF Letter I''); letter from David T. Bellaire, Executive Vice President and General Counsel, Financial Services Institute, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''FSI Institute Letter I''); letter from Rick Foster, Vice-President and Senior Counsel, Financial Services Roundtable, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''Financial Services Roundtable Letter''); letter from Fintegra, LLC (''Fintegra Letter''); letter from Alexander I. Rorke, Senior Managing Director, Hilliard Lyons, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''Hilliard Letter''); letter from Thomas E. Dannenberg, President and CEO, Hutchinson Shockey Erley and Co., to Ronald W. Smith, Corporate Secretary, MSRB, dated January 20, 2015; letter from Andrew Hausman, President, Interactive Data, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''Interactive Data

comments were received in response to *Regulatory Notice* 15–36.[30] A copy of *Regulatory Notice* 14–52 is attached as Exhibit 2a. A list of comment letters received in response to *Regulatory Notice* 14–52 is attached as Exhibit 2b, and copies of the comment letters received in response to *Regulatory Notice* 14–52 are attached as Exhibit 2c. A copy of *Regulatory Notice* 15–36 is attached as Exhibit 2d. A list of comment letters received in response to *Regulatory Notice* 15–36 is attached as Exhibit 2e, and copies of the comment letters received in response to *Regulatory Notice* 15–36 are attached as Exhibit 2f.

Summary of Initial Proposal and Comments Received

As proposed in *Regulatory Notice* 14–52, if a firm sold to a customer and bought the same security as principal from another party on the same trading day, the firm would have been required to disclose on the customer confirmation (i) the price to the customer; (ii) the price to the firm of the same-day trade (reference price); and (iii) the difference between those two prices.[31] The initial proposal would apply where the transaction with the customer was of a ''qualifying size,'' of 100 bonds or less or bonds with a face value of $100,000 or less, which was designed to capture those trades that are retail in nature.

Of the 31 comments FINRA received on the proposal, 6 supported the proposal, while 25 commenters generally opposed the proposal or made recommendations on ways to narrow substantially the scope of the proposal. Generally, commenters that supported the proposal stated that the proposed confirmation disclosure would provide additional post-trade information to investors that would be otherwise difficult to ascertain.[32] Three commenters, including the CFA and the SEC Investor Advocate, stated that this additional information would put investors in a better position to assess whether they are paying fair prices and the quality of the services provided by their broker-dealer, and also could assist investors in detecting improper practices.[33] The CFA and DelphX indicated that the proposal would foster increased price competition in fixed income markets, which would ultimately lower investors' transaction costs.[34] Two commenters recommended that the proposal not be limited to retail trades under the proposed size threshold, but that disclosure should be made on all trades involving retail customers, regardless of size.[35]

Other commenters opposed the proposal on several grounds. Commenters questioned whether the proposed disclosure would provide investors with useful information,[36] or whether the disclosure would simply create confusion among investors.[37] Commenters asserted that the proposed methodology for calculating the reference price is overly complex[38] and would be costly for firms to implement.[39] Commenters also indicated the proposal could cause some dealers to exit the retail broker market, either because firms would be reluctant to adapt to the new disclosure requirement, or because of increased costs and the potentially lower profits.[40]

Several commenters suggested ways to narrow the scope of the proposal. Some commenters recommended that FINRA limit the disclosure obligation to riskless principal transactions involving retail investors, as this would more accurately reflect dealer compensation

Letter''); letter from Scott A. Hayes, President and CEO, Institutional Securities Corp., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 2, 2015 (''ISC Letter''); letter from Vincent Lumia, Managing Director, Morgan Stanley Smith Barney LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''Morgan Stanley Letter I''); letter from Jed Bandes, President, Mutual Trust Co. of America Securities, dated December 23, 2014 (''Mutual Trust Letter''); letter from Hugh D. Berkson, Executive Vice-President, Public Investors Arbitration Bar Association, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''PIABA Letter I''); letter from Joseph R.V. Romano, President, Romano Brothers and Co., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 19, 2015 (''Romano Letter''); letter from Paige W. Pierce, President and CEO, RW Smith & Associates, LLC, dated January 21, 2015 (''RW Smith Letter I''); letter from Rick A. Fleming, Investor Advocate, SEC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''SEC Investor Advocate Letter I''); letter from Sean Davy, Managing Director and David L. Cohen, Managing Director, SIFMA, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''SIFMA Letter I''); letter from Robert A. Muh, CEO, Sutter Securities Inc., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''Sutter Securities Letter''); letter from Karin Tex, dated January 12, 2015 (''Tex Letter''); letter from Kyle C. Wootten, Deputy Director—Compliance and Regulatory, Thomson Reuters, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 16, 2015 (''Thomson Reuters Letter I''); letter to Cynthia Friedlander from Scott D. Baines, Principal, Umpqua Investments, Inc., dated January 20, 2015 (''Umpqua Investments Letter''); letter from Bonnie K. Wachtel, CEO, and Wendie L. Wachtel, COO, Wachtel and & Co Inc., to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 16, 2015 (''Wachtel Letter''); letter from Robert J. McCarthy, Director of Regulatory Policy, Wells Fargo Advisors, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 20, 2015 (''Wells Fargo Letter I'').

[30] *See* Letter from Michael Nicholas, Bond Dealers of America, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''BDA Letter II''); letter from Micah Hauptman, Consumer Federation of America, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''CFA Letter II''); letter from Kurt N. Schacht and Linda L. Rittenhouse, CFA Institute, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''CFA Institute Letter''); letter from Chris Melton, Coastal Securities, to Marcia E. Asquith, Corporate Secretary, FINRA (''Coastal Securities Letter II''); letter from Herbert Diamant, Diamant Investment Corporation, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 30, 2015 (''Diamant Letter II''); letter from Norman L. Ashkenas and Richard J. O'Brien, Fidelity Investments, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''Fidelity Letter II''); letter from Darren Wasney, Financial Information Forum, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''FIF Letter II''); letter from David T. Bellaire, Financial Services Institute, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015, (''FSI Institute Letter II''); letter from David P. Bergers, LPL Financial LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 10, 2015 (''LPL Letter''); letter from Elizabeth Dennis, Morgan Stanley Smith Barney LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''Morgan Stanley Letter II''); letter from Hugh D. Berkson, Public Investors Arbitration Bar Association, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 8, 2015 (''PIABA Letter II''); letter from Paige W. Pierce, RW Smith and Associates, LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''RW Smith Letter II''); letter from Jason Clague, Charles Schwab and Co., to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''Schwab Letter''); letter from Rick A. Fleming, Office of the Investor Advocate, SEC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''SEC Investor Advocate Letter II''); letter from Sean Davy and Leslie M. Norwood, Securities Industry and Financial Markets Association, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''SIFMA Letter II''); letter from Manisha Kimmel, Thomson Reuters, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''Thomson Reuters Letter II''); letter from Thomas S. Vales, TMC Bonds LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''TMC Bonds Letter''); letter from Robert J. McCarthy, Wells Fargo Advisors LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated December 11, 2015 (''Wells Fargo Letter II'').

[31] The initial proposal would also apply to instances where the firm buys bonds from a customer and sells the same bonds as principal to another party on the same trading day.

[32] *See, e.g.,* SEC Investor Advocate Letter I at 2.

[33] *See* CFA Letter I at 1; DelphX Letter at 2; SEC Investor Advocate Letter I at 2.

[34] *See* CFA Letter I at 1; DelphX Letter at 3.

[35] *See* Eder Letter I at 1; PIABA Letter I at 2.

[36] *See* Diamant Letter at 5; Romano Letter at 3–4; Sutter Securities Letter at 2.

[37] *See* BDA Letter I at 4–5; Diamant Letter I at 6; FSI Institute Letter I at 3; Morgan Stanley Letter I at 2; SIFMA Letter I at 17; Wells Fargo Letter I at 5; CIG Letter at 1.

[38] *See* Fidelity Letter I at 4; FIF Letter I at 2; SIFMA Letter I at 24–26; Thomson Reuters Letter I at 6; Wells Fargo Letter I at 8.

[39] *See* BDA Letter I at 2–3; Diamant Letter I at 7–8; Fidelity Letter I at 4–5; FIF Letter I at 2; FSI Institute Letter I at 5; Financial Services Roundtable Letter at 5; Morgan Stanley Letter I at 3; Wells Fargo Letter I at 7–8; Umpqua Investments Letter at 1.

[40] *See* Brean Letter at 1; Diamant Letter I at 7; FSI Institute Letter I at 8; Umpqua Investments Letter at 1.

and transaction costs,[41] and would be more consistent with the stated objectives of the SEC in this area and of the proposal itself.[42] Some commenters suggested that the proposed rule should apply to riskless principal transactions as previously defined by the Commission, wherein the broker-dealer has an ''order in hand'' at the time of execution.[43] One commenter, however, did not think that such a limitation would appreciably reduce the complexity or cost of the proposal.[44] Commenters also suggested that FINRA eliminate institutional trades from the scope of the proposal: For example, by not covering institutional accounts as defined in FINRA Rule 4512, or sophisticated municipal market professionals as defined in MSRB Rule D–15.[45] Both Fidelity and SIFMA stated that the proposal should permit trading desks that are separately operated within a firm to match only their own trades for purposes of pricing disclosure.[46] Morgan Stanley and SIFMA also stated that transactions between affiliates should not constitute a firm principal trade that, if accompanied by a same-day customer trade, would trigger the disclosure requirement.[47] Commenters also suggested that the proposal exempt the disclosure of mark-ups on new issues.[48] One commenter suggested that this exemption should exempt the disclosure of mark-up/mark-downs on transactions in new issues executed at the public offering price on the date of the issue's sale.[49]

Rather than proposing reference price disclosure, several commenters suggested that FINRA instead enhance TRACE, in part by providing greater investor education about TRACE,[50] and requiring firms to make those systems more accessible[51] by, for example, providing more near-real-time TRACE information to investors[52] or providing a link to TRACE on customer confirmations,[53] or by aggregating all TRACE data on a single Web site.[54]

In response to the comments received on *Regulatory Notice* 14–52, FINRA proposed several modifications to the proposal. First, FINRA proposed to replace the qualifying size requirement with an exclusion for transactions that involve an institutional account, as defined in FINRA Rule 4512(c). This would ensure that all eligible transactions involving retail customers, regardless of size or face amount, would be subject to the proposed disclosure and was responsive to firms' concerns about using disparate definitions of a retail customer. Second, FINRA proposed to exclude from the proposed disclosure those transactions which are part of fixed-price offerings on their first trading day and which are sold at the fixed-price offering price. Variable price offerings would remain subject to the proposed disclosure.[55]

Third, in response to concerns from commenters that having the disclosure requirements triggered by trades made by separate trading departments or desks would undermine the legal and operational separation of those desks, FINRA staff proposed to exclude firm-side transactions from the proposed disclosure that are conducted by a department or desk that is functionally separate from the retail-side desk, *e.g.,* where the firm can demonstrate through policies and procedures that the firm-side transaction was made by an institutional desk for an institutional customer that is separate from the retail desk and the retail customer, and that the institutional desk had no knowledge of the retail order. However, if, for example, the transactions and positions of the separate department or desk are regularly used to effect the transactions at the retail desk, this exception would not apply.

Fourth, in response to concerns from commenters about having the disclosure requirements triggered by trades between affiliates, FINRA proposed to exclude 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. Some commenters stated that acquiring a security through an affiliate was functionally similar to an inventory trade, and that using this trade as the basis for a reference price calculation would be of limited value, especially if the affiliate acquired its position over multiple trading days.[56] To the extent that disclosure is not required where the firm principal trade occurs on a previous trading day, *e.g.,* the firm sells the security to a customer out of its inventory, this exception would apply a similar concept to trades involving affiliates. Fifth, to address concerns raised by commenters that customers may be confused by reference price information provided on volatile trading days where there are large price swings between the time of the trade with the customer and the firm's own trade, FINRA proposed that firms be required to provide a link to TRACE on the customer confirmation, and permitted firms to omit the reference price in the event of a material change in the price of the security between the time of the firm principal trade and the customer trade. Sixth, in response to concerns about the operational burdens associated with determining the reference price for certain ''complex'' trade scenarios, FINRA would permit members to use alternative methodologies for more complex trades.[57]

As discussed above, FINRA developed its initial proposal in consultation with the MSRB, and the initial FINRA and MSRB proposals were substantially similar. However, in response to comments, the MSRB proposed a different disclosure framework than FINRA. Specifically, the MSRB proposed requiring a firm to disclose the amount of the firm's mark-

[41] *See* Hilliard Letter at 2; Morgan Stanley Letter I at 2; SIFMA Letter I at 29; Wells Fargo Letter I at 11.

[42] *See* SIFMA Letter I at 31.

[43] *See* Hilliard Letter at 2; SIFMA Letter I at 30; Wells Fargo Letter I at 11.

[44] *See* Thomson Reuters Letter at 7.

[45] *See* BDA Letter I at 6; FIF Letter I at 3; Morgan Stanley Letter I at 3.

[46] *See* Fidelity Letter I at 8; SIFMA Letter I at 36.

[47] *See* Morgan Stanley Letter I at 3; SIFMA Letter I at 21.

[48] *See* BDA Letter I at 6; Coastal Securities Letter I at 1; SIFMA Letter I at 22.

[49] *See* Coastal Securities Letter I at 1.

[50] *See* Fidelity Letter I at 7; FSI Institute Letter I at 6–7; Financial Services Roundtable Letter at 6; Hilliard Letter at 3; Morgan Stanley Letter I at 2; SIFMA Letter I at 15–16.

[51] *See* Thomson Reuters Letter I at 7.

[52] *See* Wells Fargo Letter I at 7. Other commenters noted the difficulty of providing TRACE/EMMA data on the confirmation. *See* Romano letter at 4.

[53] *See* Fidelity Letter I at 7; FSI Institute Letter I at 6; Hilliard Letter at 3; Morgan Stanley Letter I at 2; SIFMA Letter I at 15–16.

[54] *See* FIF Letter I at 4; FSI Institute Letter I at 6; Romano Letter at 3–4; SIFMA Letter I at 15–16.

[55] In a fixed-price offering, bonds are generally sold at par and at the same price to all investors, and the compensation paid to the firm, such as the underwriting fee, is captured in the prospectus. In contrast, variable price offerings are reported as secondary trades, may involve investors paying different prices, and may be difficult for firms to distinguish from other kinds of secondary trades.

[56] *See* SIFMA Letter I at 21.

[57] FINRA proposed that, where there is a principal transaction and a customer transaction of the same size (or the principal transaction exceeds the size of the customer trade) without intervening trades within the same trading day, the price of the principal trade should be used as the reference price. However, where there is not a same-size principal and customer trade scenario or there are one or more intervening trades of a different size, the staff proposed that firms should be allowed to employ a reasonable alternative methodology in calculating the reference price, such as the average weighted price of the firm trades that equal or exceed the size of the customer trade, or the price of the last same-day trade executed as principal by the firm prior to the customer trade (or closest in time if executed after), irrespective of the size of that principal trade. FINRA also proposed that the firm must adequately document, and consistently apply, its chosen methodology.

up (or mark-down) from the prevailing market price for certain retail customer transactions, rather than the reference price paid by the firm and the differential between the reference price and the price paid by the customer. Under the MSRB's proposal, the firm would be required to disclose its mark-up or mark-down 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 customer within two hours of the customer transaction. The disclosed mark-up would be required to be expressed both as a total dollar amount and as a percentage. The MSRB also proposed exempting firms from disclosure when the firm and customer trades were conducted by functionally separate trading desks. For trades among affiliates, the MSRB 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 is required. Additionally, the MSRB proposed to require the disclosure of two additional data points, even if mark-up disclosure would not be required under the MSRB's proposal. First, the MSRB proposed to require firms to add a CUSIP-specific link to EMMA on all customer confirmations. Second, the MSRB proposed to require on all customer confirmations the disclosure of the time of execution of a customer's trade.

Given the importance of achieving a coordinated approach with the MSRB, in *Regulatory Notice* 15–36 soliciting comment on the revised proposal, FINRA included a description of the MSRB's mark-up disclosure approach and invited comments on any relative merits and shortcomings of the MSRB's approach as compared to FINRA's revised approach.

Summary of Revised Proposal and Comments Received

In response to the revised proposal, some commenters reiterated that retail investors would benefit from some form of enhanced price disclosure. For example, the CFA stated that increased price disclosure would provide investors with the opportunity to make more informed investment decisions, and would foster increased price competition in the fixed income markets.[58] The SEC Investor Advocate stated that some kind of regulatory solution was necessary, as retail investors in fixed income securities ''remain disadvantaged by the lack of information they receive in confirmation statements.'' [59] The PIABA stated that abuse of undisclosed mark-ups and mark-downs is not a hypothetical problem, and that making additional pricing information available could result in customers being charged more favorable prices.[60]

A number of commenters supported disclosing the mark-up, as based on the prevailing market price, instead of the reference price.[61] BDA recommended that the disclosure should be displayed either in dollar terms or as a percentage of the markup relative to the inter-dealer price.[62] Both BDA and Schwab stated that the reference price proposal would be costly, difficult for firms to implement and for retail customers to understand, and may not provide customers with meaningful information about the costs associated with particular transactions.[63] Schwab noted that, under the reference price proposal, a customer may receive disclosure for the execution of one lot of a particular order, but not for another lot of the same order.[64] Schwab stated that the reference price proposal would also reflect market fluctuations, so that a customer may infer that the dealer lost money on a transaction with a customer, even if a mark-up was charged.[65] Fidelity stated that the proposed disclosure requirement should focus on the difference between the price the customer was charged for a fixed income security and the prevailing market price of the fixed income security.[66] While Fidelity agreed that a dealer's actual contemporaneous costs or proceeds are a reasonable proxy for the prevailing market price in some situations, it stated that there are many situations in which a dealer's costs or proceeds are not a reasonable proxy for the prevailing market price.[67] Fidelity proposed that the prevailing market price be defined as the dealer's best available price for the subject security under the best available market at the time of trade execution.[68] Fidelity proposed different methodologies that dealers could apply when determining the prevailing market price, including (1) looking at a trader's mark-to-market at the end of the day; (2) contemporaneous cost; (3) top of book; and (4) vendor solutions that offer real time valuations for certain securities.[69]

Other commenters noted that the reference price proposal could negatively impact firms' efforts to generate timely confirmations.[70] In supporting the mark-up disclosure approach, the SEC Investor Advocate noted that mark-up disclosure, although it may lead to disclosure of a smaller cost to an investor under some circumstances, nonetheless provides relevant information about the actual compensation the investor is paying the dealer for the transaction, reflects market conditions and has the potential to provide a more accurate benchmark for calculating transaction costs.[71] LPL noted that mark-up disclosure would be relevant to retail transactions in all kinds of fixed income securities that might be the subject of future disclosure requirements.[72]

Some commenters opposed requiring that the firm principal and customer trades occur closer in time to each other, such as two hours, as had relatedly been proposed by the MSRB. The CFA and the SEC Investor Advocate noted that a shorter timeframe would increase the possibility that firms would attempt to evade the disclosure requirement by holding onto positions.[73] Other commenters, including Morgan Stanley and SIFMA, indicated that the timeframe for disclosure should be shortened to the two-hour window.[74] These commenters stated that the two-hour window would capture the majority of the trades at issue, and also be easier to implement.[75] Commenters stated that the concern that a shorter timeframe would facilitate gaming of the disclosure requirement was misplaced, as it was unlikely that firms would change trading patterns and increase risk exposure merely to avoid disclosure.[76] They also said that FINRA has sufficient access to data to determine if firms were attempting to game the two-hour disclosure window.[77]

Commenters generally supported the change of the scope of the proposal from the ''qualifying size'' standard (transactions involving 100 bonds or

[58] *See* CFA Letter II at 6.

[59] *See* SEC Investor Advocate Letter II at 2.

[60] *See* PIABA Letter II at 3.

[61] *See* BDA Letter II at 6; Fidelity Letter II at 5; FSI Institute Letter II at 5; LPL Letter at 1; Schwab Letter at 3–4; SEC Investor Advocate Letter II at 5.

[62] *See* BDA Letter II at 2.

[63] *See* BDA Letter II at 4–5; Schwab Letter at 2.

[64] *See* Schwab Letter at 2.

[65] *See* Schwab Letter at 2.

[66] *See* Fidelity Letter II at 7–8.

[67] *Id.*

[68] *Id.* at 7.

[69] *Id.* at 8.

[70] *See* Fidelity Letter II at 11; FIF Letter II at 3; Schwab Letter at 4.

[71] *See* SEC Investor Advocate Letter II at 5.

[72] *See* LPL Letter at 4.

[73] *See* CFA Letter II at 2; SEC Investor Advocate Letter II at 5.

[74] *See* Diamant Letter II at 7; Morgan Stanley Letter II at 3; SIFMA Letter II at 7.

[75] *See* Diamant Letter II at 7; Morgan Stanley Letter II at 3; SIFMA Letter II at 7.

[76] *See* Morgan Stanley Letter II at 3; RW Smith Letter II at 2; SIFMA Letter II at 10.

[77] *See* RW Smith Letter II at 2.

less or $100,000 face amount or less) to transactions with non-institutional accounts.[78] The CFA noted that the revised standard would help ensure that all retail transactions would receive disclosure, regardless of size.[79]

Three commenters opposed the proposal to require firms to disclose the time of the execution of the customer transaction.[80] FIF stated that this proposal would create additional expense for firms, and could not be adjusted in connection with any trade modifications, cancellations or corrections.[81] FIF also indicated that the execution time was not necessary for securities that trade infrequently, as investors should not have difficulty ascertaining the prevailing market price at the time of their trade.[82] Schwab indicated that this would not be a necessary data point for investors.[83]

Other commenters, however, supported including the time of execution of the customer trade. Thomson Reuters stated that including the time of execution would allow retail investors to more easily identify relevant trade data on TRACE[84] and FSI stated that this would allow investors to understand the market for their security at the time of their trade.[85]

Commenters also supported adding a general link to TRACE.[86] FSI and SIFMA supported the proposal to add a link to the TRACE Web site on customer confirmations instead of a CUSIP-specific link, as a CUSIP-specific link could be inaccurate or misleading, and could be difficult for firms to implement.[87] BDA stated that a general link to the main TRACE page would be operationally easier to achieve.[88]

Commenters supported the proposed exclusion for transactions involving separate trading desks,[89] although Schwab indicated that this exception should be subject to information barriers and rigorous oversight.[90] The CFA suggested FINRA specifically require, in the rule text, that firms have policies and procedures in place to ensure functional separation,[91] and the SEC Investor Advocate suggested that FINRA provide greater guidance as to what constitutes a functional separation.[92]

Some commenters supported the proposal, in cases of transactions between affiliates, to ''look through'' to the affiliate's principal transaction for purposes of determining whether disclosure is required.[93] FIF and Thomson Reuters stated, however, that not all firms are able to ''look through'' principal trades, given information barriers and the fact that firms often conduct inter-dealer business on a completely separate platform than the retail business.[94]

With respect to the proposed exemption for fixed-price new issues, the two commenters that addressed this issue, CFA Institute and SIFMA, supported the proposed exemption.[95]

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether 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 email 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 Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–FINRA–2016–032. This file number should be included on the subject line if email 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 Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change 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 Web site 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 also will be available for inspection and copying at the principal office of the Exchange. 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 September 9, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[96]

Robert W. Errett,

Deputy Secretary.

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[78] *See* CFA Letter II at 4; CFA Institute Letter at 3; Coastal Securities Letter II; PIABA Letter II at 2; Schwab Letter at 5; SIFMA Letter II at 15.

[79] *See* CFA Letter II at 4.

[80] *See* FIF Letter at 5; Schwab Letter at 6; SIFMA Letter at 16.

[81] *See* FIF Letter at 5.

[82] *See* FIF Letter at 6.

[83] *See* Schwab Letter at 6.

[84] *See* Thomson Reuters Letter at 2.

[85] *See* FSI Letter at 7.

[86] *See* BDA Letter II at 3; Coastal Securities Letter II; FSI Institute Letter II at 6.

[87] *See* FSI Institute Letter II at 6; SIFMA Letter II at 19.

[88] *See* BDA Letter II at 3.

[89] *See* CFA Institute Letter at 5; Schwab Letter at 6; SIFMA Letter II at 15.

[90] *See* Schwab Letter at 6.

[91] *See* CFA Letter II at 5.

[92] *See* SEC Investor Advocate Letter II at 6.

[93] *See* CFA Institute Letter at 5; Fidelity Letter II at 11–12; PIABA Letter II at 2; Schwab Letter at 6; SIFMA Letter II at 18.

[94] *See* FIF Letter II at 5; Thomson Reuters Letter II at 3.

[95] *See* CFA Institute Letter at 4; SIFMA Letter II at 15.

[96] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 32218; File No. 812–14599]

Wells Fargo Bank, National Association, et al., Notice of Application

August 16, 2016.

AGENCY: Securities and Exchange Commission (''Commission'').