Morgan Stanley
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Morgan Stanley

January 20, 2015

BY ELECTRONIC MAIL

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

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

Re: FINRA Regulatory Notice 14-52,
Pricing Disclosure in the Fixed Income Markets

MSRB Regulatory Notice 2014-20,
Request for Comment on Draft Rule Amendments to
Require Dealers to Provide Pricing Reference
Information on Retail Customer Confirmations

Dear Ms. Asquith and Mr. Smith:

Morgan Stanley Smith Barney LLC ("MSSB") is pleased to provide comments on behalf of itself and its affiliate, Morgan Stanley & Co LLC ("MSCO" and together with MSSB, "Morgan Stanley"), to the Financial Industry Regulatory Authority's ("FINRA") Regulatory Notice 14-52 and the Municipal Securities Rulemaking Board's ("MSRB") Regulatory Notice 2014-20 (together, the "Proposals").

MSSB is dually registered as a broker-dealer and an investment adviser, and MSCO is a registered broker-dealer. MSSB operates one of the largest wealth management organizations in the world, with over $2.0 trillion in client assets as of December 31, 2014. MSSB offers personalized services to its wealth management clients through its more than 16,000 financial advisors. MSSB and MSCO maintain an extensive inventory of fixed income securities and also source securities from third parties, in each case to provide liquidity on both sides of the market to customers of both broker dealers.

Morgan Stanley supports FINRA's and MSRB's goal of enhancing fixed income price transparency for retail investors and appreciates the opportunity to comment on the Proposals.

Morgan Stanley generally supports the views advanced by the Securities Industry and Financial Markets Association ("SIFMA") in its forthcoming comment letter on the Proposals. However, given the size and unique characteristics of our retail and institutional businesses and our experience in fixed income markets generally, we wish to comment on particular aspects of the Proposals:

1. Matching Methodology and Disclosure

Morgan Stanley is concerned the matching methodology set forth in the Proposals will confuse investors and inaccurately represent a dealer's contemporaneous cost as well as its compensation and transaction costs. In particular, the likelihood of intra-day volatility and the degree of such volatility increases as the window for matching trades increases, such that the matched or "reference transaction" may no longer represent the prevailing market price for the security and the resulting differential may over or understate dealer compensation. Moreover, as a result of the complexity of the matching methodology, investors are not likely to understand why pricing information is disclosed on some trade confirmations and not others, nor what the reference transaction represents or how it was determined for their particular trade (for example, whether a "LIFO" or volume weighted average approach was utilized to match customer trades to a group of reference trades under the FINRA Proposal). In addition, under the Proposals, it is conceivable that similarly situated investors trading on the same side of the market roughly contemporaneously would receive disclosures of different matched trades by application of the methodology or one investor may receive a disclosure while the other does not.

In order to address these concerns with the matching methodology and disclosures, consistent with SIFMA's comment letter on the Proposals, Morgan Stanley would support enhancing TRACE and EMMA and promoting their use by retail customers through investor education. As noted by SIFMA in its comment letter, the MSRB recently acknowledged that the Proposal "would provide investors with information generally already publicly available" on EMMA.[1] Among other important data, TRACE and EMMA provide investors with information concerning the prevailing market price of their securities so they are better positioned to assess the quality of their trade executions and dealer's contemporaneous cost and compensation. Dealers could also assist in this effort by providing links on trade confirmations to TRACE and EMMA.

In light of the Proposals' objective to enhance transparency concerning dealer compensation and transaction costs, Morgan Stanley suggests FINRA and MSRB limit any confirmation disclosure requirement to riskless principal transactions, consistent both with the Securities and Exchange Commission ("SEC") recommendations cited in the Proposals, as well as with existing SEC disclosure requirements for equity securities. While such a disclosure requirement would impose significant implementation costs, it would more accurately represent dealer compensation and transaction costs and address many of the challenges presented by the Proposals as described above and in the SIFMA comment letter. Should FINRA and MSRB extend any disclosure obligation beyond riskless principal transactions, Morgan Stanley urges FINRA and MSRB to narrow substantially the time window during which trades are matched to fifteen minutes, consistent both with the existing timeframe for complying with trade reporting obligations, as well as MSRB's recent study of secondary market transactions in municipal securities which reported that the vast majority of intraday paired trades occur within fifteen

[1] MSRB, 2014 Annual Report at 6.

minutes.[2] While the implementation costs of such a disclosure obligation would be significant, the narrowed time window substantially mitigates the risk of volatility and investor confusion and would also enable FINRA and MSRB to simplify the matching methodology. Alternatively, in lieu of disclosing matching or reference transaction prices, disclosure could consist of the most recent TRACE or EMMA print in the applicable security.

2. Inter-affiliate Transactions

As SIFMA commented, any disclosure obligation should not apply where the customer trade is matched to a trade between the dealer and its affiliate. As described above, MSSB and MSCO fulfill client trades using inventory held by both dealers. The "trade" between these dealers is tantamount to a booking move across entities and should not be construed as a matched or reference transaction under the Proposals. Investors should not receive different disclosures depending upon whether their dealer utilizes the inventory of one or more affiliated entities.

3. Trades with Sophisticated Clients

Morgan Stanley also shares SIFMA's view that in addition to only requiring disclosures for trades below a certain size, specific price reference disclosure should not be required for trades with sophisticated customers (such as qualified purchasers (as defined in Investment Company Act Section 2(a)(51)), institutional accounts (as defined in FINRA Rule 4512(c) and MSRB Rule G-8(a)(xi)) and sophisticated municipal market professionals (as defined in MSRB Rule D-15(a))), regardless of trade size as these customers commonly transact in trade sizes below the threshold in the Proposals. As SIFMA notes, these are established concepts which evidence a regulatory or congressional determination that the clients in question do not require the same type of protection afforded to retail investors. These types of investors have the sophistication to assess pricing and are also more likely to have relationships with multiple dealers and to transact with those that provide more favorable pricing. In addition, utilizing existing sophisticated investor standards that firms already employ within their businesses would simplify implementation in comparison to developing a new definition of retail investor for purposes of the Proposals.

4. Implementation Costs and Challenges

Finally, Morgan Stanley stresses the implementation costs and challenges associated with the Proposals, both for firms individually and when aggregated across the industry. These costs and burdens should be viewed in light of the broader concerns expressed above and in the SIFMA comment letter and should be compared against the costs and benefits of the alternative approaches to increase transparency in the fixed income markets suggested by SIFMA and Morgan Stanley.

[2] MSRB, Report on Secondary Market Trading in the Municipal Securities Market (July 2014), at 24 (Figure III.F).

In conclusion, rather than implement an overly complex, confusing and costly disclosure requirement, Morgan Stanley urges FINRA and MSRB to explore the alternatives suggested by SIFMA and Morgan Stanley to address the policy objectives set forth in the Proposals.

We appreciate the opportunity to provide comments to FINRA and MSRB on the Proposals and look forward to a continuing dialog on this important rulemaking initiative. We would be pleased to discuss any questions FINRA or MSRB may have with respect to this letter.

Respectfully submitted,

Vincent Lumia
Managing Director
Morgan Stanley Smith Barney LLC