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BY ELECTRONIC MAIL

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Ronald W. Smith
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Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
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**Re: FINRA Regulatory Notice 15-36,
Pricing Disclosure in the Fixed Income Markets**

**MSRB Regulatory Notice 2015-16,
Request for Comment on Draft Rule Amendments to
Require Confirmation Disclosure of Mark-ups for Specified Principal
Transactions with Retail Customers**

Dear Ms. Asquith and Mr. Smith:

Charles Schwab & Co. Inc. ("Schwab") appreciates the opportunity to comment on the recent rule proposals by the Financial Industry Regulatory Authority ("FINRA") and the Municipal Securities Rulemaking Board (the "MSRB") regarding the disclosure of certain pricing and mark-up or mark-down (collectively "mark-up") information on customer confirmations for qualifying retail transactions in fixed income securities (the "2015 FINRA Proposal", the "2015 MSRB Proposal", and collectively the "2015 Proposals").

Schwab understands that the 2015 Proposals are an attempt to address the comments and concerns raised in response to FINRA Regulatory Notice 14-52 and MSRB Notice 2014-20 (the "2014 FINRA Proposal", the "2014 MSRB Proposal", and collectively the "2014 Proposals").

Schwab has been a long-time proponent of disclosing transaction-related costs across all asset classes and currently provides information on confirmations for customers on its retail platform related to the mark-ups it charges on municipal, corporate, and government agency bond transactions. Schwab believes that it is important for

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investors to understand how bond pricing works and how the associated costs will ultimately determine the price of the bond they purchase or sell. Schwab has made resources available to its clients that describe how bonds are priced and how those prices can ultimately impact the yield received on a bond transaction. In addition, Schwab makes available to its clients pricing information from both FINRA and the MSRB. Schwab firmly believes that the more investors understand about pricing and the markets, the better they will be able to judge the fairness and value of the services they receive. To that end and as further described below, Schwab believes that an expanded approach to disclosing transaction related costs coupled with consistent and reasonable rulemaking in this area would be helpful to market participants and retail investors alike.

Schwab appreciates FINRA's and the MSRB's willingness to listen to and incorporate some of the feedback provided in response to the 2014 Proposals into the 2015 Proposals. While both sets of Proposals have been an important step toward improving price transparency and better informing retail investors' understanding of the fixed income securities markets, as more fully described below, Schwab believes that an expanded approach to mark-up/pricing disclosure whereby all principal transactions are included can have a greater impact for retail investors and the market as a whole.

Concerns with the 2014 and 2015 Proposals

Schwab, like many other market participants, believes that using a "reference price"¹ as proposed by FINRA would not have the intended effect of increasing transparency into transaction costs and dealer compensation related to fixed income transactions. Rather, we believe that such an approach would be difficult for dealers to implement, potentially difficult for retail investors to understand, and most importantly, may not provide meaningful information related to the costs associated with a particular transaction. As the MSRB succinctly explained in its 2015 Proposal, the reference price approach would, "utilize potentially complicated methodologies to determine which of the potentially many transactions should be used as a comparator for purposes of disclosing to the customer pricing reference information".² Schwab believes that such a complicated approach would not necessarily improve transparency nor would it improve retail investors' understanding of the fixed income securities markets. In fact, it has the potential to exacerbate investor confusion.

For example, under the proposed "reference price" methodology, a customer might receive a reference price disclosure for the execution of one lot of a particular order, but no disclosure for another lot of the same order. Another possible scenario is that a particular reference price disclosure would infer that a dealer lost money on a transaction with a customer, even though a mark-up was charged. If a goal of the Proposals is to provide greater transparency into transaction costs and dealer

¹ See FINRA Regulatory Notice 15-36, Pricing Disclosure in the Fixed Income Markets (October 2015).

² See MSRB Notice 2015-16, Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers (September 2015).

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compensation associated with trading fixed income securities, Schwab believes that a reference price approach would result in many scenarios that would not meet that objective.

While Schwab is in agreement with both FINRA and the MSRB that pricing and mark-up disclosure has the potential to positively impact the market, we believe that the 2015 Proposals are either too complex (as described above), or may not go far enough in providing meaningful pricing/mark-up information to retail investors (as more fully described below).

First and foremost, Schwab believes it is imperative that FINRA and the MSRB coordinate with each other to ensure that their proposals are consistent, except for any differences mandated by the unique market structures of the covered securities. As presently written, the two proposals are markedly different and would be expensive and difficult to implement and maintain in parallel, and ultimately would confuse retail investors and stray from the stated objectives of the Proposals. In addition, FINRA and the MSRB must also consider pending rulemaking by the Department of Labor,³ which in its present form would impose yet another disclosure regime for certain principal fixed income transactions in retirement accounts.

At a high level, under the 2015 FINRA Proposal, with some exceptions, for specified security transactions occurring on the same trading day, firms/members would be required to disclose on retail customer confirmations: the price to the customer; the firm's "reference price"; and the difference between the two prices. Generally speaking, the "reference price" would be based upon the price at which the firm/member acquired or sold the subject security on the same trading day.

Under the 2015 MSRB Proposal, firms/members would be required to disclose on retail customer confirmations its mark-up or mark-down (collectively "mark-up") from the "prevailing market price" for the security, expressed as a total dollar amount and as a percentage of the principal amount of the transaction for principal transactions for which the firm had transacted on the same side of the market within the two hours preceding or following the customer transaction.

Of the two 2015 Proposals, Schwab believes the 2015 MSRB Proposal has the greatest potential to be effective at achieving the stated goals of FINRA, the MSRB, and the Securities and Exchange Commission⁴ in the area of fixed income price transparency. As noted above, under the 2015 MSRB Proposal, the mark-up required to be disclosed would be the difference between the price to the customer and the prevailing market

³ Department of Labor, Employee Benefits Security Administration. Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, Application No. D-11713 [ZRIN: 1210-ZA25], 80 Federal Register 21989 (April 20, 2015).

⁴ U.S. Securities and Exchange Commission, Report on the Municipal Securities Market, (July 31, 2012).

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price ("PMP") for the security. The presumption as noted in the 2015 MSRB Proposal is that the PMP for the security would be established by referring to the dealer's contemporaneous cost as incurred, or the contemporaneous proceeds as obtained, which is consistent with applicable MSRB and FINRA rules.⁵

Schwab is concerned that any "reference price" methodology may too often fail to provide customers with clear and accurate disclosure of dealer mark-ups. Disclosure of differences between customer prices and reference prices for dealer risk trades will reflect market price fluctuations and, as previously mentioned, may infer a dealer loss on a transaction with a customer for which the dealer charged a mark-up.

Additionally, proposed reference price differential disclosures would require dealers to delay the confirmation process until the end of the day, potentially presenting significant operational and technological challenges. More importantly, delaying the calculation of the required disclosure until the end of the day would preclude dealers who wish to do so from providing the disclosure to customers at the point of sale. Customers of those dealers who disclose mark-ups at point of sale will inevitably be confused by reference price differential disclosures on trade confirmations that differ from the dealers' point of sale mark-up disclosures. This is one reason Schwab believes it is imperative that the disclosure requirement be based on a price that already exists at the time of trade, such as the PMP, rather than on prices that occur in the future.

Schwab Supports Expanding the MSRB's Proposal to Include All Principal Trades

While we agree with the general principles of the MSRB's Proposal, Schwab recommends going further. We believe that disclosing the mark-up from the PMP for all principal trades in municipal, corporate, and government agency bonds regardless of the time frame or whether the dealer had transacted on the same side of the market would provide even greater transparency into the compensation and costs associated with the execution of transactions and would provide significantly more benefits to investors and to the marketplace as a whole. In addition to providing increased benefits to retail investors, Schwab believes that such an approach would also more closely align the fixed income markets with the disclosure requirements currently in place in the equity markets.

As noted in the 2015 MSRB Proposal, in principal transactions, "...the total transaction price to the customer must bear a reasonable relationship to the prevailing market price of the security at the time of the customer transaction, and the mark-up, as part of the aggregate price, must also be fair and reasonable. For purposes of [MSRB] Rule G-30, the mark-up is calculated based on the inter-dealer market price prevailing at the time of the customer transaction." As the MSRB notes in their Proposal, dealers are already subject to regulatory obligations related to the fairness and reasonableness of mark-ups, and the determination of PMP in connection with the establishment of a fair price, as such, it is a reasonable assumption that dealers should be able to provide the

⁵ See MSRB Rule G-30 and FINRA 2120.

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amount of the mark-up over the PMP for all principal transactions, not just those for which they've transacted on the same side of the market within two hours of the customer's transaction or during the same trading day.

Under this expanded disclosure approach, dealers and customers would not have to interpret newly defined terms such as "reference price", "complex trades", or the timing of "specified principal transactions." Nor would dealers need to determine if there is a specified trade size associated with the customer's transaction. As the MSRB notes in its 2015 Proposal when discussing an alternative regulatory approach which would include all principal transactions, "[S]uch a requirement may eliminate the need for dealers to develop any type of matching utility to determine which customers receive disclosure and would allow confirmations to be printed immediately following the customer's transaction." Dealers would simply need to disclose the mark-up from the PMP which they presumptively have already calculated. This approach would be consistent with current requirements to disclose agency commissions on fixed income transactions. As long as dealers are held to the same standards for calculating PMP, Schwab believes that this approach would provide investors with even greater transparency into the compensation of their dealers and the costs associated with the execution of their transaction. Schwab believes that this approach would also simplify dealer obligations under the 2015 Proposals and mitigate behavior, intentional or not, that could lead to the appearance of circumventing the intended benefits of the 2015 Proposals.

While Schwab believes that this approach is more straightforward and would achieve both FINRA's and the MSRB's stated objectives, it would likely require updated guidance from both FINRA and the MSRB on the determination of PMP and on what constitutes a mark-up. Collectively, this guidance could equate to a "reset" for dealer expectations and go a long way toward ensuring a level playing field going forward.

Additional Comments

Disclosure Format

Schwab is supportive of the MSRB's proposal to express the mark-up both as a total dollar amount and as a percentage of the principal of the customer transaction. Schwab requests that sufficient time be allowed for required system updates to be made in order to implement these changes.

Retail Customers in the Secondary Market

Schwab supports using a definitional approach in identifying which trades would be subject to the disclosure requirements of the 2015 Proposals. Schwab feels that a "retail account" or "non-institutional account" as defined by FINRA and MSRB rules is a more appropriate method to capture covered transactions as opposed to the \$100,000 par amount threshold put forth in the 2014 Proposals. In addition, Schwab supports limiting disclosure obligations to transactions which occur in the secondary market.

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"Look Through" for Specified Trading Structures

Schwab strongly believes that any final rule must include a "look through" provision for specified trading structures. Schwab agrees with the MSRB assertion that such a provision would ensure that the mark-up disclosed is a more accurate indication of the compensation paid by customers when affiliated dealers effectively function as a single entity for the purposes of executing customer transactions. If such transactions were not captured by the rule, Schwab believes that customers of firms who have separate trading desks within affiliated entities would not be afforded the benefits intended by the 2015 Proposals. Such disclosure would, in our opinion, help ensure a level playing field for all market-participants.

Functionally Separate Trading Desks

While Schwab understands and generally agrees with the reasoning behind excluding transactions effected on functionally separate trading desks from the disclosure requirements of the 2015 Proposals, we believe that such exclusions must be coupled with information walls and rigorous oversight. Lack of such controls could limit the manifestation of the 2015 Proposals' stated objectives.

Security-Specific Link to EMMA and TRACE, and Time of Execution

Schwab is supportive of the proposal to add a security-specific link to EMMA and FINRA's TRACE websites. Schwab believes that the additional information available on EMMA and TRACE can be a valuable resource for investors and market participants. As both FINRA and the MSRB can appreciate, the provision of security-specific links will require a great deal of coordination with industry participants to ensure that links remain functional and accurate. FINRA and the MSRB would have to commit to a process by which they notify industry participants of planned updates and outages of their systems to ensure ongoing connectivity. In addition, due to already limited physical space on customer confirmations, such URLs would need to be appropriately sized to ensure that firms can fit them into the limited space available on confirmations. Should the MSRB and FINRA adopt Schwab's proposal to disclose mark-ups from the PMP, we believe that time of execution would not be a necessary data point for confirmations.

In general, Schwab believes that evaluating the costs and burdens of any new rule requirements and weighing those costs against any benefits derived from them is critical to ensure efficient and effective rulemaking. Before any new requirements are created, FINRA and the MSRB should conduct a thorough cost-benefit analysis of requirements set forth in these Proposals.

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Thank you for your consideration of the points we have raised in this letter and we hope that you find that our comments are useful in helping to formulate your final rules. Please feel free to contact Michael Moran at (415) 667-0902 if you have any questions.

Sincerely,



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