

Morgan Stanley

December 11, 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 15-36,
Pricing Disclosure in the Fixed Income Markets

MSRB Regulatory Notice 2015-16,
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 15-36 (the “FINRA Proposal”) and the Municipal Securities Rulemaking Board’s (“MSRB”) Regulatory Notice 2015-16 (the “MSRB Proposal,” and together with the FINRA Proposal, 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 nearly \$2.0 trillion in client assets as of September 30, 2015. MSSB offers personalized services to its wealth management clients through its more than 15,800 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 continues to support 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

(the “SIFMA Letter”). 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. The Importance of Objective Disclosure Methodology

Morgan Stanley is concerned the Proposals do not adequately provide for objectively determined disclosures and, as a result, risk causing confusion for the very investors they are designed to benefit while exposing dealers to the risk of liability if their methodology and disclosures are subsequently challenged. Morgan Stanley notes that customer trade confirmations currently contain objective, factual information, including data about the security and transaction that are obtained from third party data providers or calculated using clearly defined inputs and formulas (such as accrued interest and yield to worst). Morgan Stanley is supportive of providing additional confirm disclosure for its retail investors, but any such disclosure should be formula based and not subject to interpretation.

While the Proposals on their surface may appear to call for objectively determined disclosures, they lack the specificity and guidance necessary for that end. Even with the narrower window proposed by the MSRB, determination of an exact mark-up is challenging at best in the fixed income over the counter marketplace. This is particularly difficult for firms that maintain substantial balance sheets of continuously changing inventory and that often transact in and out of cusips in the course of their market-making activities to meet the demands of customers and counterparties. Moreover, intervening market, sector and issuer events can render a potentially contemporaneous transaction an unreliable indicator of prevailing market price. In contrast, while the FINRA Proposal advances a formulaic, objective approach, it does not offer enough specificity or establish a particular regulator-approved methodology that firms could employ consistently in compliance with any eventual rule.

Accordingly, Morgan Stanley supports the adoption of an alternative readily determined price reference framework as described in the SIFMA Letter. Specifically, Morgan Stanley believes that disclosure of VWAP and the differential as a percentage of par between VWAP and the price to the customer provide investors with valuable insight into the quality of their execution in the context of the broader market for their securities. Further, VWAP could be consistently disclosed across firms, would be easily explained to, and understood by, retail investors, would not be misleading and would be objectively determined. In addition to these benefits, we believe the cost of implementation would be lessened as VWAP could be calculated by FINRA and MSRB and imported onto confirms like other referential data is disclosed. For the same reasons, Morgan Stanley would also support other objective disclosures referenced in the SIFMA Letter, such as ‘high/low’ reported trade prices.

While VWAP or another readily determined price reference framework offers considerable advantages to customers and firms alike and achieves meaningful disclosure, Morgan Stanley would also support a matching framework consistent with the SIFMA Letter, provided that FINRA and MSRB adopt one or more approved objective methodologies in the Proposals. The FINRA Proposal advances a matching framework but requires more guidance and specificity for firms so they can be assured of being in compliance with any disclosure

requirements. Morgan Stanley also supports an exclusion from the disclosure requirements as described in the FINRA Letter due to an “unusual and material change in the price of a bond;” however, any such exclusion should also permit firms to factor in market- and sector-related developments in determining whether disclosures are required.

2. Time Frame for Disclosure

Consistent with the SIFMA Letter, Morgan Stanley believes a two-hour time frame for disclosure is appropriate and supported by FINRA’s and MSRB’s data which demonstrate that the vast majority of all “paired” trades occur within a very narrow window of time (see, for example, Section IIIA and the corresponding footnotes in the SIFMA Letter), which is well short of the two-hour window in the MSRB Proposal. Moreover, a narrower window substantially mitigates the risk of volatility and investor confusion and would reduce the likelihood firms would need to subjectively determine whether an intervening event was impactful enough to warrant not providing the disclosure.

Morgan Stanley respectfully submits that concerns around the risk of gaming in the context of a narrower window are misplaced. Considering the vast majority of paired trades occur well within the two-hour period, it seems highly unlikely firms would change trading patterns and materially increase risk exposure by holding positions longer merely to avoid disclosure, in particular considering the risk of non-compliance. Any remaining concerns about firms delaying executions can be substantially mitigated by supervisory policies and procedures (including surveillance) and regulatory examination and enforcement activities.

3. Uniform FINRA and MSRB Disclosure Rule

Morgan Stanley agrees with SIFMA and wishes to emphasize the importance of FINRA and MSRB developing a uniform, harmonized disclosure requirement. The risks presented by inconsistent requirements, the resulting investor confusion and the costs of implementation of two frameworks would greatly exceed the benefit (if any) of having discrete requirements under applicable FINRA and MSRB rules. Further, the timeline for implementing different FINRA and MSRB methodologies would significantly extend the period firms would require to conform to any eventual disclosure requirements.

4. Inter-Affiliate Transactions

Morgan Stanley appreciates MSRB’s and FINRA’s treatment of affiliate transactions under the Proposals, but as noted in the SIFMA Letter and above, Morgan Stanley requests a harmonized approach. Echoing our comments on the earlier MSRB and FINRA proposals, 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.

5. Implementation Costs and Challenges

Finally, Morgan Stanley stresses the significant 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 Letter and should be compared against the costs and benefits of the approaches to increase transparency in the fixed income markets suggested by Morgan Stanley and SIFMA. Specifically, a simple, consistent application of a clearly defined reference price (whether that reference price is VWAP, a matched price or a price determined from an alternate approach) that is not subject to a large number of inputs or contingencies would not only mitigate the potential for investor confusion, but would also make implementation less expensive.

Conclusion

In conclusion, rather than implement overly complex, confusing, costly and inconsistent disclosure requirements, Morgan Stanley respectfully requests FINRA and MSRB explore the alternatives suggested by Morgan Stanley and SIFMA to address the policy objectives set forth in the Proposals. In particular, Morgan Stanley urges FINRA and MSRB to develop a uniform approach to pricing disclosure which would permit firms to adopt an objective readily determined price reference framework as described above. Such a framework would provide meaningful, consistent disclosures to clients and increased transparency in the marketplace. An alternative matching framework could also address the concerns Morgan Stanley has with the Proposals, so long as FINRA and MSRB provide the necessary specificity concerning regulator-approved matching methodologies.

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,



Elizabeth Dennis
Managing Director
Morgan Stanley Smith Barney LLC