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February 7, 2018

VIA ELECTRONIC MAIL

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street NE.,
Washington, DC 20549

RE: Follow-up Regarding Retail Confirmation Mark-up Disclosure

Dear Chairman Clayton:

We are writing this letter to follow-up on our meetings on January 17, 2018, with you, Commissioner Stein and Commissioner Piwowar's staff in which we discussed our concerns relating to the May 14, 2018, effective date of the FINRA and MSRB rules that will require dealers to disclose mark-ups and mark-downs on retail investor trade confirmations for specified transactions (the "Retail Disclosure Rules"). In response to those meetings, we are writing this letter:

- To propose a conformance period in implementing the Retail Disclosure Rules;
- To provide you with a more detailed explanation of the practical technology, vendor and operational challenges facing BDA members concerning the implementation date of May 14, 2018; and
- To reiterate a concern we have been discussing with FINRA and the MSRB that the Retail Disclosure Rules will have the unintended, detrimental market structure impact of creating a disincentive for capital committing firms to actively provide liquidity and product offerings to their own customers, effectively imposing a competitive burden on competition that is not necessary or appropriate.

A BDA Proposal to Address Implementation Concerns.

After our meetings on January 17, 2018, we met with our members to develop a

proposal that would respond to two concerns raised in those meetings: (1) a development of a "business plan," which would represent concrete steps that dealers would take to ensure that they take advantage of any time provided by the SEC, FINRA and the MSRB; and (2) consideration by the BDA of approaches to addressing these concerns without a formal amendment to the Retail Disclosure Rules. The BDA believes that we have developed a proposal that integrates both of these concerns, as well as the concerns we raised in our meetings. Our members have worked in good faith to implement the Retail Disclosure Rules and, as we explain below, our goal is to ensure that dealers can develop sound, systematic processes that produce accurate and meaningful mark-up disclosures to retail investors.

The BDA believes that the following are the key aspects of our proposal: (1) each dealer should meet the requirements of the business plan we describe below, including the development of an implementation plan that contains concrete deadlines for each step of implementation of the Retail Disclosure Rules, (2) the deadlines contained in each implementation plan should provide for the dealer to fully implement the Retail Disclosure Rules no later than December 31, 2018, (3) each dealer should act in good faith to comply with the deadlines of its implementation plan, (4) FINRA and the MSRB should have the ability to inspect those implementation plans and dealer compliance with the related deadlines, (5) any dealer who fails to meet the requirements of its implementation plan such that it cannot reasonably implement and test its compliance with the Retail Disclosure Rules by December 31, 2018, could be found to violate the Retail Disclosure Rules after May 14, 2018, unless the dealer otherwise complies with the Retail Disclosure Rules; and (6) FINRA and the SEC would provide written guidance to the effect that, as long as a dealer meets the requirements of (1)-(3) above, FINRA and the SEC will not enforce the Retail Disclosure Rules until December 31, 2018.

Business Plan. The BDA believes that the following represent concrete steps that each dealer should take between now and December 31, 2018, in order to ensure that they comply with the Retail Disclosure Rules by then:

- By May 14, 2018[1], each dealer should choose a vendor who will calculate prevailing market price ("PMP Vendor")[2], and the dealer should have an agreement with the PMP Vendor providing for a schedule (1) for when the PMP Vendor will deliver its product (the "PMP Solution"), (2) for implementation and integration of that PMP Solution into the other systems and vendors of the dealers, and (3) for the testing of that PMP Solution, that is consistent with the dealer's implementation plan we

[1] We note that our members believe that this is reasonably achievable based on feedback they have received from PMP Vendors. But, as we explain below, our members depend on PMP Vendors to provide their PMP Solutions and, while our members anticipate that this step is achievable by May 14, 2018, our members cannot cause the PMP Vendors to fulfill their part.

[2] We note that some dealers, while representing a small amount of trades in the industry, will not contract with a PMP Vendor but nevertheless are delayed in their implementation of the Retail Disclosure Rules because of the impact that the Retail Disclosure Rules will have on their order management system. Thus, there are likely some dealers who will not meet this element of the business plan but still should have the ability to develop an implementation plan.

describe below; and

- By May 14, 2018, each dealer should develop an implementation plan pursuant to which the dealer establishes a specific schedule that provides the dealer a reasonable basis that it will comply with the Retail Disclosure Rules on or before December 31, 2018. A demonstrable implementation plan must include:

    - The steps necessary to integrate the PMP Solution with the front-end order system of the dealer and any other pertinent operating systems of the dealer;

    - The steps necessary to integrate the PMP Solution with other relevant vendors of the dealer, including clearing and confirmation vendors of the dealer; and

    - The steps necessary to test the integrity of the dealer's systems to ensure the effective operation of its order, clearing and confirmation processes.

Conformance Period. The BDA believes that the SEC, FINRA and the MSRB can address dealer implementation concerns through written guidance by the SEC and FINRA that provides dealers with a conformance period which would provide that:

- If a dealer, in good faith, takes the demonstrable, concrete steps of the business plan we describe above, then FINRA and the SEC would not enforce the Retail Disclosure Rules until the earlier of the completion of the dealer's implementation plan, or December 31, 2018; or

- A dealer who cannot establish that it has taken the concrete steps of the business plan must comply with the Retail Disclosure Rules from or after its current effective date of May 14, 2018.

The BDA believes that our proposal allows for a balancing of the concerns of all parties because it affords dealers the time they need to implement the operational changes necessary to comply with the Retail Disclosure Rules, and it provides the regulators the confidence that the time afforded by the conformance period is used effectively by dealers to ensure that they will comply with the full Retail Disclosure Rules by December 31, 2018.

The BDA believes that it is critical, though, that the conformance period for the Retail Disclosure Rules not contain a component that requires dealers to place any mark-up disclosure on customer confirmations until the earlier of the completion of a dealer's implementation plan, or December 31, 2018, as long as they follow the requirements of the business plan we outline above. While we explain in more detail our concerns with implementation of the Retail Disclosure Rules below, due to the state of vendor preparedness, the core of those concerns is that dealers are very anxious that calculations

of prevailing market price are currently unreliable and thus result in nonsensical mark-up disclosures, and would be therefore very difficult to explain to retail investors and almost certain to confuse a large percentage of retail investors. In addition, dealers are very concerned that any requirement would place them into the difficult position of either having concerns with violating the Federal antifraud laws because they knowingly would make disclosures with suspect accuracy, or having concerns that they are in violation of the Retail Disclosure Rules. Accordingly, the BDA strongly believes that a conformance period for the Retail Disclosure Rules should be clear that dealers are not required to place mark-up disclosure on customer confirmations until after the conformance period.

Practical Limitations in Implementing the Retail Disclosure Rules.

Why are dealers so concerned about implementation? Even with respect to clear and accurate mark-up disclosure, our members expect that retail investors will need time to understand this new information. At least for a while, we anticipate that many retail investors will be confused by the new mark-up disclosures. We cannot recall any SRO rule change in recent history that will have such a direct and immediate impact on information that retail fixed-income investors receive. It is in this light that we express these concerns about the ability of our members and pertinent industry vendors to capably implement the Retail Disclosure Rules. Our members are highly concerned that, if the Retail Disclosure Rules are effective on May 14, 2018, many retail investors will receive rushed, untested, nonsensical and confusing information on their confirmations. This will not serve anyone's best interests.

We also note that the complexity of implementing the Retail Disclosure Rules is directly connected to capital commitment concerns by dealers because the complexity of calculating prevailing market price is especially prevalent when dealers execute at-risk trades in less actively traded securities. Under the Retail Disclosure Rules, dealers have to follow a mechanical waterfall to determine prevailing market price, which relegates quotations at the bottom of permissible evidence to establish prevailing market price. Creating a PMP Solution that consistently and accurately calculates prevailing market price that follows the waterfall and results in accurate and meaningful information to the retail investors is a large part of why implementing the Retail Disclosure Rules requires considerable time. As such, our members feel that, if they need to disclose mark-up on confirmations starting May 14, 2018, they are on the horns of a dilemma with dealers having to choose between confusing their retail investors (and potentially violating the Federal antifraud laws) or pulling back from committing capital in less actively traded securities until they are comfortable that they are providing retail investors with accurate information. Both of the sides of this dilemma would negatively impact retail investors, who are the intended beneficiaries of the Retail Disclosure Rules.

What is the concern? Our central concern is that there is an inadequate amount of time for dealers to develop, integrate and test multi-layered, complex systematic processes, which are critical to ensuring reasonably accurate mark-up information is disclosed on retail investor confirmations, before the current effective date because PMP Vendors have not provided their PMP Solutions to dealers in time. Most dealers will be using three or more different vendors to process and maintain inventory activity records,

to calculate prevailing market price, and to generate confirmations. PMP Vendors have still not provided their PMP Solution to allow dealers to begin this process. As a result, most dealers have not developed, let alone begun testing, systematic processes for capturing customer trades that are subject to disclosure (*i.e.* where dealer inventory activity is equal to or greater than customer trade size), timeframes and pricing methodology when a dealer will use its inventory cost/proceeds as prevailing market price. As noted above, this is especially problematic for at-risk trades where reliance on a vendor-calculated prevailing market price is expected to produce routine deviations from actual market value, and which will require greater analysis and due diligence before dealers are reasonably comfortable that the mark-up disclosures based on those prevailing market price calculations are accurate and meaningful.

To give you a sense of the amount of time it will take for dealers to implement the Retail Disclosure Rules, implementation will entail several "critical path" processes, which means that several steps can only begin to make progress after other steps are completed or are close to being completed. Our members have expressed a typical set of four critical path processes that need to occur in consecutive order before they can develop a reasonable basis that they comply with the Retail Disclosure Rules.

- First, PMP Vendors need to provide a testing environment for their PMP Solution, which entails integrating the front-end, order system of the dealer so that it can properly interface with the PMP Vendor's data.

- Second, after the first step, the dealer needs to ensure that the data from the PMP Vendor can properly interface with the dealer's clearing vendor to make sure that the PMP is properly included into each trade file and that the dealer's computer systems can properly access the PMP in each trade file to ensure that the appropriate mark-up is calculated.

- Third, after the second step, the dealer needs to ensure that the trade file from the clearing vendor can be received and integrated by the dealer's confirmation vendor to make sure that the information is properly displayed and formatted on the confirmation that the retail investor will receive.

- Fourth, after the third step, the dealer needs to test the integrity of the entire process, from front-end orders to displaying the mark-up on confirmations.

While estimates from dealers vary, our members generally estimate that the minimum amount of time it will take to complete the first, second and third steps will altogether take approximately three months from the time that the PMP Vendor makes its data available for testing. PMP Vendors have varied in their dates when they expect that to occur, with some indicating as early as the beginning of March, and with others indicating later. Our members estimate that the fourth step will take approximately one month if everything goes as expected. But what these estimates do not take into consideration is that implementing the Retail Disclosure Rules is a massive undertaking

and dealers are concerned that there may be road bumps in that process that will create unexpected delays. What these timelines also do not take into consideration is the important customer communication efforts that dealers will need to undertake. Our members estimate that they will need to start notifying their retail customers of the new mark-up disclosure approximately two months before customers start receiving affected confirmations, and dealers cannot do that until they know what information the customers will receive, which dealers will not know until later in the implementation process. Given these timelines, our members are convinced that there is inadequate time to complete all these steps before May 14, 2018, but are also confident that they can implement the Retail Disclosure Rules by December 31, 2018.

This is not a concern of effort but of impossibility. In expressing these concerns, we want to underscore that our members have acted in good faith to implement the Retail Disclosure Rules by May 14, 2018, but the timing of PMP Vendor preparedness has made reasonable compliance by then impossible. One of the difficult aspects of the Retail Disclosure Rules is that compliance depends on PMP Vendors to provide effective products because most small-to-medium sized dealers simply cannot develop internal systems capable of the complex tasks of collecting the available information and calculating prevailing market price on a computerized, mechanical basis. Our members stand ready and willing to do everything they can to implement the Retail Disclosure Rules, but that effort can only start when the PMP Vendors finish their work.

If the effective date remains, we expect a feeding frenzy for access to PMP Vendors. If the current effective date remains, our members do not expect that PMP Vendors will treat all dealers the same, and that our members will be adversely impacted by the bargaining power of the very large dealers. Our members in particular are at the mercy of PMP Vendors to provide their PMP Solutions and make themselves available to integrate their data with the data of our members and their outside vendors. If a May 14, 2018, effective date remains, we expect that there will be a triage effort by PMP Vendors that will most negatively impact our members.

Bifurcated compliance deadlines may compound the problem. The BDA is aware that there have been some discussions of a bifurcated compliance solution to these implementation concerns, which would require some information required to be disclosed on confirmations to retail investors starting May 14, 2018, with the more-difficult information to be required later. The BDA does not believe that this is plausible solution because it only keeps dealers from the work of integrating PMP Solutions and testing their systems to comply with the full Retail Disclosure Rules. We believe that a bifurcated compliance deadline would slow down the process – not speed it up – because it would be tantamount to dealers complying with two separate set of rules rather than one. Dealer efforts should be focused on implementing the full Retail Disclosure Rules as soon as possible.

BDA Proposals Regarding Capital Commitment Firms.

Separate from our concerns with the May 14, 2018, effective date of the Retail Disclosure Rules, we would like to reiterate our concern that the Retail Disclosure Rules

will have unintended consequences to capital committing dealers. Our concern is that customers will perceive that risk-committing dealers charge more than firms that execute trades in a riskless capacity, without understanding the risks taken and benefits that are provided by dealers that provide liquidity to the markets. This remains a significant concern and we believe is at odds with mark-up disclosure requirements for equity securities, which are pegged from the reported price and which do not require the effective disclosure of Bid-Ask spread. The BDA has previously sent to FINRA and the MSRB (which we have also forwarded to the SEC) trade data that shows how this kind of trading has happened in the past and we expect it to occur in the future.

The BDA has presented various alternative proposals to address these concerns. One set of these proposals allow capital committing firms to bypass contemporaneous cost in the prevailing market price waterfall with respect to securities they generally offer to the market, including other dealers. Another set of these proposals would have the same effect but would only impact what is disclosed to retail investors.

In addition to providing dealers the necessary time to implement the Retail Disclosure Rules, a conformance period for the Retail Disclosure Rules would allow FINRA and the MSRB to make necessary adjustments to avoid these unintended consequences.

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We hope that this letter is responsive to the SEC's concerns. Please reach out to us with any questions or comments.

Sincerely,

Michael Nicholas
Chief Executive Officer
Bond Dealers of America

cc:
Honorable Kara M. Stein, Commissioner, SEC
Honorable Michael S. Piwowar, Commissioner, SEC
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