D I A M A N T
INVESTMENT CORPORATION

Comprehensive Portfolio Management

November 30, 2015

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K St. NW
Washington, DC 20006-1506

RE: FINRA Proposed Ruling 15-36

Dear Ms. Asquith,

Diamant Investment Corporation (Diamant) is making the below constructive comments regarding the above proposed ruling detailed in the FINRA Proposed Ruling 15-36 (Proposal). The reason for making these comments is that is after reading the text of this proposed rule change, it became clear that FINRA, a regulatory authority charged with creating rules for the corporate bond industry, is continuing to demonstrate excessive regulatory overreach to a properly functioning bond marketplace, without an understanding of damages the Proposal will have for the very retail customer they are claiming to help. As this Proposal is essentially identical to the 14-52 Proposal with only very minor changes, it becomes imperative that the FINRA Board take a step back from the minutia of this Proposal and grasp the enormity of what such a Proposal as 15-36 will do to the corporate bond industry.

The Corporate Bond Business

Diamant is a small, self-clearing, bond dealer that has been in business for over 40 years serving the investment needs of retail investors. I have developed considerable expertise in the retail bond business, having worked full time at Diamant, our family owned business, for over 37 years. Although the Proposal was clearly written by articulate policy makers and lawyers, it is remains very clear they have a near complete lack of understanding of the way bonds trade.

In the fixed income marketplace, business is conducted in large, but imperfect auction market. It is an auction marketplace that is dependent on bids and offers from a diverse group of bond dealers that position bonds for future sale. In the corporate bond market, bonds are not fungible, many CUSIPS trade infrequently (i.e. are not actively traded), and there are different characteristics between bond issues. There are complexities in locating and evaluating fixed income bonds that do not exist in other markets.

This auction market for fixed income bonds is completely different than transactions in the stock market. In the stock market, as little as 5,000 stocks trade in a manner where the same CUSIP can be traded on any given day in the year. With stocks, a customer order can be directed and executed on a listed stock exchange in a riskless agency transaction. It is important to recognize that bonds simply do not work this way. This is all pretty basic stuff, but

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apparently this point continues to be missed when proposals like this effectively treat corporate bond trading just like a riskless agency transaction.

Many broker/dealers engage in transaction in bonds. If riskless agency trading of bonds actually worked over time for broker/dealers, then competitive market forces would force agency trading to become widespread in the bond industry. Given the characteristics of corporate bonds (as described above), effecting principal trades in the auction market place is the method that nearly every broker/dealer uses to transact business.

Despite the use of computers and various bond listing systems, the bond industry remains a fragmented auction market place where large bond dealers, mid-size bond dealers, and small bond dealers all co-exist, with each type of firm providing strength to a part of the market place. Just because this industry remains an auction market does not mean the current system is broken, or needs substantial regulatory interference in the guise of helping the customer.

Economic Baseline Assumptions

The data presented in this Proposal does not support passing this Proposal. Using recent trade data, we now know that 93% of same sized corresponding corporate bond trades occur within 10 minutes. The average price spread is 0.73%. As with any average, there are trades with larger price spreads. There is no indication that these 93% of the corporate bonds trades harmed the customer. And there may be circumstances that justify a trade with higher spreads. Such a trade may have been for a small piece (such as a 5M piece); combined with either a long maturity; or a lower quality credit that trades with larger spreads; or an infrequently traded bond. Perhaps such a trade simply required more retail costs to properly handle the customer needs. This information is interesting to learn. Yet it does not indicate any violation of FINRA rules.

Although I have no reason to doubt the integrity of the people preparing the statistics, these economic baseline assumptions are missing trade information. All these trades occurred during a period of time when the capital markets have been distorted by actions of the Federal Reserve. Interest rates have been artificially low for seven years. With the certainty of losing principal value when rates increase, smaller, professional broker/dealers like Diamant have steered customers away from buying corporate bonds. Thus trade spreads and time frames from such broker/dealers are not part of the FINRA statistics. Since firms like Diamant do not trade bonds within these short times, the absence of such firms materially trading in the time frames analyzed suggest the data presented in this Proposal does not truly reflect the entire corporate bond auction market place in a normal economic environment.

No Need For The Proposed Rule

In the section titled "Need for the Rule" the assertion is made that the need for this Proposal is because FINRA is concerned investors are limited in their ability to understand and compare transactions costs. Why is the need to understand and compare the transaction costs of a bond dealer important to a customer unless they plan on becoming a bond dealer? Over the last several decades that I have been following the bond markets, FINRA has not reported a substantial pattern of pricing abuse within the corporate bond auction marketplace, and they would have already taken action to remedy such issues. So this Proposal is not based on a real problem with retail trades, but rather on an unproven premise that it would be somehow helpful for a bond dealer to provide a customer with the gross markup in certain bond trades. Without demonstrating a real need, FINRA is practicing regulatory overreach in creating rules to solve a problem that does not exist.

Still A Very Bizarre Line Of Reasoning

This entire Proposal is based on the premise that markups are somehow bad. This presumption has little to do with "helping" the customer with confusing partial disclosure. We all must recognize it has the feel of a politically driven effort to penalize a business sector by attempting to eliminate profits in the fixed income bond business. Which industry will be next?

There seems to be a misguided belief that securities bond dealers can continue to operate in a compliant manner in an already heavily regulated industry; can add substantive additional compliance and operational costs to attempt to adhere to this Proposal; can continue to risk capital to provide a supply of securities to their customers; and can provide associated ongoing investment securities services to their customers; all while earning little or any gross profit. This theory simply will not work in the business world.

The reasoning behind this Proposal is that by forcing disclosure of the gross trade profit of a bond dealer, customers will somehow be better informed about the characteristics of the corporate bond investment they are making. By itself this is a very bizarre line of reasoning that is not used in any other decision making in the purchase of either small or large ticket items. Again, to illustrate just a few examples:

> When a customer purchases either a new or used car, they never see the gross profit that the car manufacturer and/or the car dealer is making, as their focus properly is on securing a piece of transportation that meets their needs.
>
> When a customer renovates or purchases a house, they never see the gross profit of the builder or the individual seller, as their focus properly is on whether the location and structure is suited to their needs for shelter.
>
> When a customer purchases food at their local supermarket, they never see the gross profit in each item in their cart, as their focus is on shopping in a convenient location for quality merchandise that meets their needs of nourishment.

From an ethical viewpoint, once a business sector (like bond dealers) is forced to disclose its gross profits on a transaction, in an effort to achieve truly full disclosure, such disclosure should also be mandated on every transaction that a retail customer engages in during the conduct of their daily activity. Prior to turning this Proposal into a regulatory ruling, FINRA should first coordinate with all regulatory entities throughout the Federal Government and force all sectors of the U.S. economy to make similar disclosures. This would have a chilling negative impact on all sectors of the U.S. economy, and would have a near universal outcry of "big brother" or "big government" impeding free market capitalism. Yet this is exactly what this Proposal as written achieves, and it creates the ground breaking precedence to affect this disclosure on other industries.

Trading with Proposed Disclosure Rules

In the corporate bond business, the retail customer needs the assistance of a professional to navigate the selection of available fixed income products. When a client buys corporate bonds, their most important decision points may include: the income stream (coupon); years until their principal is returned (maturity date); return on the investment (yield which presumably is competitive to other similar bonds); what events can cause the principal to be returned early and what is the impact (call price and yield to call); what happens to this investment when rates move (duration); what revenue streams secure the interest payment; what assets secure the principal payment; what other alternatives are available; whether this investment should be made now revisited at another time; and whether the bond fits into a customer portfolio. Successful fixed income investment decisions have always been made on these types of important information.

What continues to make this Proposal so bizarre is that FINRA now believes customers should focus their attention not on important information described above, but instead on the disclosure of a gross trade profit number that should not be terribly relevant to the overall decision to purchase a bond.

As the FINRA Board must be well aware of, typically a bond dealer uses the gross profit from principal trading firm to cover costs that include: paying the trader; the registered representative that handled the customer discussion; the manager who oversees the trading desk and retail broker; any market risks that may occur in placing bonds into firm position; the back office operations staff that clears the trade; the external clearing costs incurred by the broker/dealer; the ongoing annual custody costs of collecting income along with any calls or maturities on the bond; the compliance and audit costs to maintain regulatory compliance within the firm; the normal costs to maintain a business such as rent and communications costs; and the ability of the broker/dealer to earn a profit for its shareholders.

The unstated objective of this Proposal is to force dealers to make a lower gross profit. Of the above costs involved with a bond trade, what part of the trade should be cut out without harming the customer? If the salesperson is compensated less to communicate with their customer, or if the trader is not paid to search the market, and/or the firm no longer wants to bother holding inventory, this all seems to run counter intuitive to "helping" the customer make prudent investment decisions in buying a corporate bond. For trades that would occur with a disclosure requirement, FINRA should expect that the customer will no longer receive the needed attention to the above critical decision points inherent in a trade, as such disclosure may reduce or eliminate the gross compensation of a dealer to provide these tasks.

Is it really helpful for a retail customer to see the gross profit printed on a bond trade? I would expect nearly every customer will call their registered representative to complain about the gross profit, regardless what the number actually is. The registered representative is not earning the gross profit, and likely is unaware of the number until after the confirmation is mailed. Why would the registered representative want to have such a conversation with their customer? In this scenario, most registered representatives will simply stop selling corporate bonds to retail customers, as it is much easier to sell other investment products with a higher sales load.

And if this gross trade profit appears on the confirmation that is received by the customer on or after settlement date, is the intent of this disclosure to permit customers to break trades because a gross profit was different than they expected? If so, then any of the specific trades that meet the disclosure requirement will have to be considered as un-firm, or incomplete transactions that may have to be reversed sometime in the future. In the future, would it not be advantageous for a customer to review trades over the past six years of disclosure, select all the trades which declined in market value, and return the trades back to the bond dealer using the reasoning the gross profit was too high on the selected trades? How would a regulator expect bond dealers to haircut their net capital for incomplete trades when the dealer does not know which trades may be returned in future periods? Clearly no bond dealer would ever want to sell bonds to customers with this type of liability.

In a recent Wall Street Journal article (October 24, 2015 page B1), a finance professor carefully picked an example of a corporate bond he felt had a high markup. On a 30M piece, he calculated a gross profit of $187.50. After a careful reading of this article, one must question his "apples to oranges" comparison of this bond trade to the ~$10 cost of a stock trade effected at a deep discount brokerage firm. Another comparison is made between the spread of a corporate bond and the bid/offering spread of a stock listed on the NYSE. Any arguments that compare exchange listed stock trading with the auction market place of corporate bond trading confirms a fundamental misunderstanding of how the corporate bond market place actually works. Thus I would discount the rationale from any academic who make such arguments.

Nonetheless, in this example, if a broker/dealer was to make the disclosure of $187.50 gross profit without explanation, how does this serve the customer? Perhaps such disclosure should detail the costs to handle the transaction to illustrate a net profit. Attempting to explain a gross profit on certain trades, versus a net profit, will hinge on the linguistic ability of the legal counsel of each bond dealer. With good lawyers, bond trades will become an event that results in both misleading and confusing customers over an irrelevant decision point.

Unintended Consequences

Smaller firms will conclude that offering corporate bonds to retail customers is not worth the added compliance costs. Diamant's proprietary back office system currently handles all customer functions related to the purchase or sale of corporate bonds. Diamant also has sufficient regulatory compliance to monitor corporate bond activity under existing regulatory rules. Yet this time tested, compliant system does not have the ability to link separate principal trades to another. It would be a major undertaking in terms of operational and software costs to re-build a back office system that could identify transactions subject to disclosure, and then place disclosure information specific to that particular trade on the confirmation. In addition, there are additional regulatory compliance costs of creating special written procedures to identify trades that would require gross profit disclosure, legal costs to prepare prudent disclosure text, along with the ongoing compliance effort to demonstrate adherence to this unprecedented trade policy and procedures.

As Diamant cannot justify the added operational costs to rebuild a back office system, the only way to comply with this Proposal is to prohibit any retail trades that fall under this Proposal as currently written. This is not a decision we take lightly, as we have been offering retail customers the ability to trade corporate bonds since 1974. Our decision to prohibit certain retail trades in corporate bonds will be based solely on this FINRA ruling.

When a seasoned broker/dealer makes such a decision as the only way to comply with this Proposal, it is easy to envision a marketplace where retail corporate bonds will be concentrated in even fewer large institutions. Concentrating trading to a handful of firms places these firms firmly in the "too big to fail" category. This means that the new definition of a fair and orderly auction marketplace will have less competition with fewer smaller firms participating. This is contrary to the concept of capitalism, but this clearly will be the outcome of this ruling, and the FINRA Board must recognize this outcome when casting their votes.

Experienced corporate bonds traders will leave the broker/dealer business. Trading will be handled by a small number of less experienced traders. As volumes pick up and trades are concentrated among a handful of firms, we should all expect more pricing errors by the remaining overworked traders. With an auction marketplace that may move towards an electronic bulletin board with fewer bids and offerings, the likely scenario is that an institutional type of customer will evolve that is not regulated by FINRA. Such an entity will use the electronic bulletin board to provide the needed liquidity for the retail customers at spreads that will benefit the institutional customer, not the retail customer.

The remaining broker/dealers handling corporate bonds will be focused on demonstrating the soundness of their compliance systems and procedures instead of the focusing on the retail customer, and will simply trade whatever is available on the electronic bulletin board. This unintended negative impact will be very beneficial to the professional traders not regulated by FINRA. As corporate bonds will then be essentially priced and offered by professional traders that are unregulated by FINRA, customers will likely pay more for the bonds regardless of what gross profit disclosure appears on a confirmation. Thus this Proposal is a no-win situation, in that the broker/dealer incurs great economic costs, potentially harms customer relationships, and the customer in the end does not gain any of the perceived benefits intended by the regulators.

A Better Time Frame

If FINRA finds itself in a political position where it need to show some action, then FINRA should design a disclosure timeframe based on its own research set forth in this Proposal. If 93% of same sized corresponding corporate bond trades occur within 10 minutes of each other, and FINRA decides to negatively impact such trading, then disclosure should occur on principal trades where matching buy and sell trades occur in this time frame. Instead an unworkable 1 day time frame from the perspective of our back office system, this disclosure timeframe should be 10 minutes. Or it could be 30 minutes, 1 hour, or even 2 hours. Any of these timeframes cover the trading identified in the Proposal. The benefit of these shorter timeframes is that small businesses, like Diamant, would be able to set up a manual review process in the back office to identify trades subject to disclosure. The shorter time frame would make it possible for smaller firms to set up procedures that use existing back office systems to achieve regulatory compliance with such a Proposal. By keeping compliance and software costs manageable, smaller firms could become, or remain active, in the business of trading corporate bonds.

Conclusion

After reviewing the Proposal and alternatives, FINRA needs to recognize this Proposal will do more harm than any good. The disclosures will clearly mislead and confuse retail investors to a degree that cannot be remedied by education, explanations, or descriptive documents accompanying a confirmation. Harming the relationship between the customer and the bond dealer, and having bond dealers reduce or eliminate retail trades, all for the sake of this misguided Proposal, simply does not add any benefit to the retail customer.

The auction marketplace has many intertwined industry participants that include retail customers; institutional customers; corporate bond dealers that trade mainly with other corporate bond dealers; and corporate bond dealers that trade mainly with their customers. All these participants within this large auction market will be adversely impacted. The larger harm will come from the auction marketplace having limited liquidity from fewer broker/dealers, or liquidity from professional institutions not subject to FINRA rules. These are very realistic outcomes from this Proposal.

To continue to maintain an orderly and regulatory compliant market in corporate bonds, FINRA must recognize the complexity within the entire fixed income marketplace, review the alternatives of enforcing existing rules, focus on firms that may fit a pattern of having a material price difference on trading corporate bonds, and commit to taking no action on the entire Proposal.

Yours truly,

Herbert Diamant

Herbert Diamant
President