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[Rule G-15](#)

## Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations

### Overview

The Municipal Securities Rulemaking Board (“MSRB”) is seeking comment on draft rule amendments to require a broker, dealer, or municipal securities dealer (“dealer”) to disclose additional information on customer confirmations for transactions in municipal securities. Specifically, the MSRB is proposing that, for same-day, retail-size principal transactions, dealers disclose on the customer confirmation the price to the dealer in a “reference transaction” and the differential between the price to the customer and the price to the dealer. This potential disclosure, made in connection with the investor’s transaction, may be significantly beneficial for purposes of the investor’s understanding of the market for the traded security. The MSRB and the Financial Industry Regulatory Authority (“FINRA”) have been engaged in ongoing dialogue in furtherance of a coordinated approach to potential rulemaking in this area. FINRA is also publishing a notice soliciting comment on a similar proposal that would apply to other areas of the fixed income market.<sup>1</sup> The MSRB is seeking comment as to all elements of its proposal, including the scope of pricing information that should be disclosed, the transactions for which such disclosures should be made, and the likely benefits and economic consequences of such a requirement for investors and dealers, including the likely costs and burdens. Specific comment is also sought as to alternatives that could similarly increase price transparency, particularly for retail customers.

Comments should be submitted no later than January 20, 2015, and may be submitted in electronic or paper form. [Comments may be submitted electronically by clicking here.](#) Comments submitted in paper form should



Receive emails about MSRB regulatory notices.

<sup>1</sup> See [FINRA Regulatory Notice 14-52 \(Nov. 2014\)](#) (“FINRA Proposal”).

be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314. All comments will be available for public inspection on the MSRB's website.<sup>2</sup>

Questions about this notice should be directed to Michael L. Post, Deputy General Counsel, or Saliha Olgun, Counsel, at 703-797-6600.

## Background

The MSRB is charged by Congress to protect investors and foster a free and open municipal securities market.<sup>3</sup> Under this mandate, the MSRB has advanced many initiatives to create and enhance MSRB products and rules with the goal of improving transparency, efficiency and other structural aspects of the market.<sup>4</sup>

First effective in 1978 and most recently amended in 2014, the MSRB's fair-pricing standards are a cornerstone of the municipal securities market.<sup>5</sup> MSRB Rule G-30, on prices and commissions, applies to dealer principal and agency transactions in municipal securities. Generally, it provides that dealers acting in a principal capacity may only purchase municipal securities from or sell municipal securities to a customer at an aggregate price (including any markup or markdown, collectively "markup") that is fair and reasonable. Similarly, when acting in an agency capacity, dealers may only

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<sup>2</sup> Comments are posted on the MSRB website without change. Personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.

<sup>3</sup> Securities and Exchange Act of 1934 § 15B(b)(2)(C), 15 U.S.C. 78o-4(b)(2)(C).

<sup>4</sup> See [MSRB Long-Range Plan for Market Transparency Products \(Jan. 27, 2012\)](#). The MSRB has requested comment and is analyzing information from market participants on potential improvements to the timeliness, fairness and efficiency of price transparency in the municipal market. See Concept Release on Pre-Trade and Post-Trade Pricing Data Dissemination through a New Central Transparency Platform, [MSRB Notice 2013-14 \(Jul. 31, 2013\)](#); Request for Comment on More Contemporaneous Trade Price Information Through a New Central Transparency Platform, [MSRB Notice 2013-02 \(Jan. 17, 2013\)](#). See also U.S. Securities and Exchange Commission, Report on the Municipal Securities Market, at pp. 117, 141 (Jul. 31, 2012) ("SEC Report") (noting MSRB transparency initiatives).

<sup>5</sup> Effective July 7, 2014, Rule G-18, on execution of transactions, and Rule G-30, on prices and commissions, were consolidated into a single rule under amended Rule G-30. See MSRB to Consolidate Dealers' Fair-Pricing Obligations into MSRB Rule G-30, [MSRB Notice 2014-11 \(May 12, 2014\)](#).

purchase or sell municipal securities for a commission or service charge that is fair and reasonable. Further, Rule G-30 requires dealers to exercise diligence in establishing the market value of the securities and the reasonableness of their compensation. FINRA Rule 2121, on fair prices and commissions, sets forth an analogous, although not identical, standard applicable to equity securities and certain debt securities, including corporate bonds.

While Rule G-30 requires that prices with respect to municipal securities transactions with customers be fair and reasonable, it does not require the disclosure of dealer compensation and/or transaction costs that are often factored into customer prices. For many securities other than municipal securities, the disclosure of such information is required on a customer confirmation under Securities and Exchange Commission (“SEC”) Rule 10b-10. For example, the rule generally requires broker-dealers, when acting in an agency capacity, to disclose the amount of any remuneration received from the customer in connection with the transaction.<sup>6</sup> Additionally, the provisions of Rule 10b-10 that require a broker-dealer to disclose the amount of its markup do not apply to municipal securities, or for that matter to any fixed income securities.

In the municipal market, MSRB Rule G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers, requires the dealer to disclose on the confirmation the price of a municipal securities transaction. With respect to agency transactions, the dealer must also disclose on the confirmation the amount of remuneration received from the customer in connection with the transaction. If the dealer is acting as principal, however, there is no requirement that the dealer disclose its markup on the confirmation. Similarly, in the corporate bond market, broker-dealers executing agency transactions must generally disclose the amount of remuneration,<sup>7</sup> but are not required to disclose the amount of any markup.

Since the 1970s, the SEC has undertaken efforts to improve price transparency and reduce transaction costs in the municipal securities and corporate bond markets, prompting several SEC rulemaking efforts. In 1976,

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<sup>6</sup> See Rule 10b-10(a)(2)(i).

<sup>7</sup> See *id.* and accompanying text. FINRA Rule 2232 on customer confirmations requires, in relevant part, a broker-dealer to send to a customer a confirmation of the transaction in accordance with SEC Rule 10b-10.

the SEC proposed to require markup disclosure by non-market makers in riskless principal transactions involving both equity and debt securities. This was followed by a 1977 proposal to require markup disclosure by non-market makers in riskless principal transactions involving equity and debt securities, but not municipal securities. In 1978, the SEC proposed to require markup disclosure for riskless principal trades in municipal securities. More recently, in 1994, the SEC again proposed to require confirmation disclosure of markups for riskless principal transactions in municipal securities.

These markup disclosure proposals were met with significant resistance. Commenter concerns focused primarily on: the potential negative effects of such disclosure on competition and market liquidity; possible compliance difficulties, including concerns about identifying the intended “riskless” principal transactions; the potential for customer confusion; and whether there was a need for such disclosures.<sup>8</sup>

In 2012, the SEC issued the Report on the Municipal Securities Market in which it broadly examined the market, including regulatory structure, market structure and market practices.<sup>9</sup> A common theme in the report was concern about transparency and pricing for customers, particularly retail customers. The report noted that, while the compensation on a municipal securities agency transaction must be disclosed as a commission, the compensation or markup on a principal transaction is not required to be disclosed.<sup>10</sup> It also noted that retail customers typically have access to substantially less pricing information than other market participants.<sup>11</sup> Without such information, investors may find it difficult to evaluate the fairness of the pricing of their securities or the costs associated with their transactions.

To address these concerns, the SEC recommended, among other things, that the MSRB consider: requiring dealers to disclose to customers, on confirmations for riskless principal transactions, the amount of any markup; encouraging or requiring dealers to provide retail customers relevant pricing reference information with respect to a municipal securities transaction effected by the dealer for the customer; and requiring dealers to seek the

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<sup>8</sup> See *e.g.* Securities Exchange Act Release No. 34962 (Nov. 10, 1994), 59 FR 59612, 59615 (Nov. 17, 1994) (“1994 Release”).

<sup>9</sup> See SEC Report.

<sup>10</sup> SEC Report at 147.

<sup>11</sup> SEC Report at 147.

best-execution of customer orders. In 2014, the MSRB announced that it was developing a proposal regarding disclosure of information by dealers to their retail customers to help them independently assess the prices they are receiving from dealers and to better understand some of the factors associated with the costs of their transactions. The MSRB further stated that the proposal would broadly seek input on alternative regulatory approaches, including markup disclosure on confirmations for trades that could be considered riskless principal transactions.<sup>12</sup>

Significant advances in the fixed income markets have helped to improve price transparency since the SEC's previous rulemaking efforts. Indeed, the SEC deferred consideration of its 1994 markup disclosure proposal due, in large part, to the planned development of systems that would make publicly available pricing information for municipal securities transactions. The SEC noted that the industry's efforts to improve transparency would result in enhanced price transparency for a broader number of transactions in the debt markets than the 1994 rule proposal would have affected.<sup>13</sup>

Launched in 2009, the MSRB's Electronic Municipal Market Access ("EMMA<sup>®</sup>") website is the municipal market's official free source of data and information on municipal securities. Through the EMMA website, market participants may access official disclosure documents, trade prices and yields, market statistics and more about virtually all municipal securities. MSRB Rule G-14, on reports of sales or purchases, currently requires dealers to report all executed transactions in municipal securities to the MSRB's Real-time Transaction Reporting System ("RTRS") within fifteen minutes of the time of trade, with limited exceptions. The RTRS system has been operational since 2005.<sup>14</sup> Since the launch of RTRS and EMMA, the MSRB has continually sought to improve price transparency in the municipal market through

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<sup>12</sup> See [MSRB Holds Quarterly Meeting, Press Release \(May 6, 2014\)](#); [MSRB Holds Quarterly Meeting, Press Release \(Aug. 5, 2014\)](#); [MSRB Holds Quarterly Meeting, Press Release \(Nov. 3, 2014\)](#). In the May press release, the MSRB also announced that it would seek SEC approval to implement a best-execution standard for transactions in the municipal securities market. The MSRB sought such approval on August 20, 2014. See Securities Exchange Act Release No. 72956 (Sept. 2, 2014), 79 FR 53236 (Sept. 8, 2014), File No. SR-MSRB-2014-07 (Aug. 20, 2014).

<sup>13</sup> See 1994 Release at 59612.

<sup>14</sup> In 2009, the MSRB additionally established the Short-Term Obligation Rate Transparency ("SHORT") system to collect and disseminate current interest rates and related information for auction rate securities and variable rate demand obligations.

enhancements to these systems.<sup>15</sup> In 2014, for example, the MSRB launched a new Price Discovery Tool on EMMA that permits market participants to more easily find and compare trade prices of municipal securities with similar characteristics.

Advances have also been made in other areas of the fixed income markets. In 2002, FINRA launched the Trade Reporting and Compliance Engine (“TRACE<sup>®</sup>”) to improve post-trade price transparency in the corporate bond market. TRACE is the over-the-counter real-time transaction reporting and dissemination service for transactions in eligible fixed income securities.<sup>16</sup> Similar to the reporting time applicable to the MSRB’s RTRS, transactions in eligible fixed income securities must be reported to TRACE generally within fifteen minutes of the time of execution. This transaction information is immediately disseminated for all securities subject to dissemination.<sup>17</sup>

With the use of information disseminated through these platforms, investors can make a more informed evaluation of the price paid or received for their fixed income securities. But because there is currently no markup disclosure requirement for fixed income securities, including municipal securities, dealers do not generally report their markups and such information is not disseminated to the market through EMMA or TRACE. Investors may, however, use EMMA and TRACE to view recent trade prices in the same or similar securities in similar quantities to compare trade prices.

Additionally, by viewing this trade data, in some cases, an investor may determine dealer acquisition cost and the investor’s transaction costs for the securities. For example, if the reported trade data on EMMA showed that only moments before an investor purchased a quantity of securities, a dealer purchase was made for the same quantity of the same securities, the

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<sup>15</sup> See *supra* n. 4 and accompanying text. On July 15, 2014, the MSRB published a report on municipal market trading patterns, associated pricing and the effect of price transparency on pricing. The report provides a baseline set of statistics about municipal bond trading to enable market stakeholders and the MSRB to make further advancements with respect to the fairness, efficiency and transparency of the municipal market.

<sup>16</sup> TRACE eligible securities generally include debt securities denominated in USD and issued by a US or foreign private issuer and with a maturity of greater than one year. Eligible securities include corporate debt, agency debentures, and asset and mortgage backed securities.

<sup>17</sup> The securities subject to dissemination by TRACE currently include publicly traded and 144A corporate debt securities, agency debentures, agency pass through mortgage backed securities traded TBA and in specified pool transactions and, as of April 2015, asset-back securities.

investor could reasonably infer that the prior trade involved his or her dealer. The investor could further infer that the differential between those trade prices accounted for the investor's transaction costs. The table below illustrates this example. While this differential is not necessarily the same as a markup,<sup>18</sup> it can provide the investor increased price transparency and significant insight into the market for the security. An analysis of this differential may also achieve many of the regulatory objectives of a markup disclosure requirement.

Trade Date/Time	Settlement Date	Price (%)	Yield (%)	Trade Amount (\$)	Trade Type
11/5/2014 3:30 PM	11/13/2014	100.975	3.882	25,000	Customer bought
11/5/2014 3:29 PM	11/13/2014	98.996	4.058	25,000	Inter-dealer trade

While these advances have generally helped to make pricing information more accessible to the market, such information still is generally directly beneficial only to those who actively seek it out. The disclosure of such information on a retail customer's confirmation would provide additional transparency even to those investors who do not actively seek out the information, including those who may not know of EMMA or may not have the time or wherewithal to conduct their own transaction research.

The MSRB, FINRA and the SEC are engaged in ongoing dialogue in furtherance of a coordinated approach to this topic.<sup>19</sup> If the MSRB and FINRA determine that rulemaking is warranted, the MSRB and FINRA plan to

<sup>18</sup> A markup is commonly considered to be the differential between the prevailing market price of a security at the time the dealer sells the security to the customer and the higher price paid by the customer to the dealer. Similarly, a markdown is commonly considered to be the differential between the prevailing market price of a security at the time the dealer purchases the security from the customer and the lower price paid to the customer by the dealer. See [Municipal Securities Rulemaking Board, MSRB Glossary](#).

<sup>19</sup> In a June 20, 2014 speech, SEC Chair Mary Jo White announced support for additional disclosures to help investors better understand the costs of their fixed income transactions. See *Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors*, Economic Club of New York, New York, NY, available at <http://www.sec.gov/News/Speech/Detail/Speech/1370542122012>. With input from SEC staff, the MSRB and FINRA have developed complementary proposals for their respective markets and will continue to pursue a coordinated approach to this issue.

institute coordinated requirements to the extent possible and appropriate in light of the differences in the municipal securities market and other areas of the fixed income markets. Among other things, this approach should assist in mitigating the potential compliance burden on dually registered dealers.

## Request for Comment

A pricing reference information disclosure requirement could be a logical next step in the MSRB's efforts to improve price transparency in the municipal securities market, and could effectively complement any future best-execution rule.

The goal of the proposed disclosures is ultimately to better inform retail investors. With relevant pricing reference information, received in the context of their securities transactions, retail investors could gain valuable insight into the market for the securities they trade. They may also more easily evaluate their transaction costs and the fairness of the price they paid or received for the securities. Additionally, knowledge on the part of dealers that such pricing information will be provided to investors may help to ensure that prices and markups are appropriate in light of the market for the security.

### Pricing Reference Information Disclosures

Under the draft amendments, a new provision would be added to Rule G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers. This provision would require a dealer to disclose on the customer confirmation its trade price for a defined "reference transaction" as well as the difference in price between the reference transaction and the customer trade. A reference transaction generally is one in which the dealer, as principal, purchases or sells the same security that is the subject of the confirmation on the same date as the customer trade. The disclosure requirement would be triggered only where the dealer is on the same side of the transaction as the customer (as purchaser or seller) and the size of such dealer transaction(s), in total, would equal or exceed the size of the customer transaction. Accordingly, for a customer sale of municipal securities to the dealer, the dealer would be required to disclose pricing information for same-day reference transactions in which the dealer sold the securities in a principal capacity. Similarly, for a customer purchase of municipal securities from the dealer, the dealer would be required to disclose pricing information for same-day reference transactions in which it purchased the securities in a principal capacity.

The proposal would require dealers to calculate and disclose the difference in price between a reference transaction disclosed on the confirmation and



the price to the customer receiving the confirmation. Thus, for example, if a dealer purchases 50 bonds in XYZ securities at a price of 100 for \$50,000 and, on the same day, sells 50 bonds in those same securities to a customer at a price of 102 for \$51,000, the dealer would be required to disclose on the customer's confirmation both the price of the reference transaction (100), which is currently available to the customer on EMMA, as well as the differential between the price of each trade (2).<sup>20</sup>

Applying the example from Table 1 above, the dealer would be required to disclose the reference transaction price of 98.996, which again is currently available to the customer on EMMA, as well as the price differential of 1.979 (calculated by subtracting the reference transaction price of 98.996 from the customer transaction price of 100.975).

An alternative approach would be to require dealers to disclose the total dollar amount differential between the reference transaction and the customer transaction.<sup>21</sup> If such an approach were pursued, in the same example above, the dealer would be required to disclose a total dollar amount differential of \$1,000 (2% of \$50,000 par amount). This approach could be pursued either in lieu of or in addition to the disclosure of the price differential as currently contemplated in the proposal. The MSRB seeks comment as to the type of pricing information dealers should be required to disclose on the customer confirmation. Are any or all of the options discussed optimal for providing customers the information that would be the most helpful to them? Are there better alternatives or equally effective alternatives that would impose fewer costs or burdens on dealers?

### **Retail Customers**

Because a goal of the proposed disclosures is to provide relevant and helpful pricing information to retail investors in particular, the proposal would require a dealer to make pricing reference information disclosures only where the transaction with the customer is a retail-size transaction. The proposal categorizes a transaction involving 100 bonds or fewer or bonds in a par amount of \$100,000 or less as a retail-size transaction. However, this

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<sup>20</sup> The price of a transaction is an expression of percentage of the principal amount of the securities. The price differential would reflect the difference in percentages of principal between the acquisition cost and transaction cost. Multiplying the price differential by the par amount transacted would provide the dollar amount difference between the acquisition cost and transaction cost. A price differential of 2 means 2% of the par amount (2% of \$50,000 or .02 x \$50,000).

<sup>21</sup> See n. 20.

approach may not necessarily capture every retail trade and may, in some instances, capture some small trades executed on behalf of an institutional customer. An alternative approach would be to require the disclosures to be made to customers that are not sophisticated municipal market professionals or SMMPs as defined in MSRB Rule D-15. The MSRB specifically requests comment as to whether these approaches or a different approach would best serve the goals of the proposal. The MSRB is interested in input, in particular, regarding whether dealers would prefer to make the proposed disclosures to all customers, rather than a subset of customers likely to be retail investors. Specifically, to the extent that the proposal would require dealers to reprogram their systems for generating confirmations to determine when the disclosures would be made, would disclosing pricing reference information to all customers mitigate the compliance burden for dealers?

### **Same-day Period**

The proposal would require a reference transaction price to be disclosed on the customer confirmation when the reference transaction is executed on the same trade date as the customer transaction. A review of EMMA trade data suggests that a significant percentage of retail-size trades have an offsetting trade in exactly the same quantity or similarly sized quantities within a short time from the customer trade. The number of these trades increases when this time period is lengthened to capture trades executed on the same date.<sup>22</sup> The MSRB believes that the disclosure of pricing reference information for trades in the same security in which the dealer acted on the same side of the transaction as the customer can provide helpful pricing information to investors. However, the MSRB recognizes that as the time period between trades increases, the degree to which the price of the reference transaction will be helpful to the customer may decrease.

An alternative to the same-day standard would be to limit the universe of trades for which pricing information must be disclosed to those trades that occur within a shorter or longer time range from the customer trade (*e.g.*, within thirty minutes of the customer trade or within two days of the customer trade). However, a shorter time period would likely result in fewer pricing reference disclosures to customers and may incentivize some dealers to time the execution of a trade so as not to trigger the disclosure

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<sup>22</sup> Trade data from EMMA shows that approximately 21.32% of retail-size trades conducted during the twelve-month period of June 2013 through June 2014 had an offsetting trade transacted by the same dealer in the same size as the customer trade and on the same trade date as the customer trade (excluding new issue trades, which for purposes of this analysis were deemed to be any trade within fifteen days of the offering sale date).

requirement. The MSRB seeks comment as to the appropriate time relation between trades for the purposes of the proposed pricing disclosures.

### **Reference Transaction Size**

Under the proposal, pricing reference information must be disclosed for reference transaction(s) that, in total, equal or exceed the size of the customer transaction. Thus, a dealer would be required to disclose pricing information for a single trade that equals or exceeds the size of the customer trade. Additionally, a dealer would be required to disclose such information for a trade that, when combined with one or more other same-day reference transactions, equals or exceeds the size of the customer trade.

When multiple dealer trades equal or exceed the amount of the customer trade, many methodologies may be available to a dealer to determine which price to disclose on the customer confirmation. These may include: disclosing the trade that is closest in time proximity to the customer trade; disclosing the last principal trade that preceded the customer trade (a last in, first out (LIFO) methodology); or disclosing the weighted average price of multiple trades. The MSRB seeks comment as to the appropriate standard(s) to apply under the proposal, as well as the situations in which such standards should be used. The MSRB also requests comment as to the costs and burdens as well as programming issues surrounding the use of one or more of these or any alternate methodologies for determining the appropriate pricing information to disclose. The MSRB specifically seeks comment on the methodologies that should be applied in the municipal securities market in examples 7, 9 and 10 in the [FINRA Proposal](#).

The proposal assumes that one or more transactions that, in total, equal or exceed the size of the customer transaction are sufficiently similar to the customer trade or may form the basis from which a dealer may fill a customer order on the same day, such that the disclosure of pricing information for these transactions may be beneficial to the customer. Notably, because the proposal would apply to customer trades for 100 bonds or fewer or bonds in a par amount of \$100,000 or less, the disclosure requirement should not have a significant impact on the institutional market for municipal securities.

Alternate size parameters might be equally or better suited to provide customers with relevant pricing information. One alternative might be to limit the disclosure of pricing information to only trade sizes that are identical to the customer's trade size. However, such a standard would result in less pricing information disclosed to the customer and may incentivize some dealers to modify trade sizes. Another alternative would be to require the dealer to disclose pricing information for its transactions in the same

securities on the same trade date if the trade sizes are within a specified range that is either smaller or larger than the customer's transaction (*e.g.* 50% smaller and 100% larger). These approaches would likely result in the disclosure of pricing reference information to fewer customers, but may result in disclosures that are more pertinent to a customer when they are made. As discussed below, the MSRB invites comment as to the proper parameters for reference transaction sizes for which pricing information should be required to be disclosed on the customer confirmation.

### **Explanatory Notations**

To help ensure that the proposed pricing reference disclosures are meaningful to customers, dealers may wish to provide explanations or descriptions, in plain language, to assist customers in understanding the disclosures. For example, such descriptions might explain that the disclosed pricing information is expressed as a percentage and might further provide brief explanation as to how the price differential was calculated. Such explanations may also be utilized to provide some context for customer interpretation and analysis of the prices, which may be particularly helpful in the event of intra-day market events or other circumstances that might at least partially explain price differentials. Explanations and descriptions, if not included on the confirmation, could be provided in materials accompanying the delivery of the confirmation. The MSRB specifically invites comment as to these aspects of the proposal.

### **Economic Analysis**

The MSRB has historically given careful consideration to the costs and benefits of its new and amended rules. The MSRB's policy on the use of economic analysis in rulemaking states that prior to proceeding with a rulemaking, the Board should evaluate the need for the rule and determine whether the rule as drafted will, in its judgment, meet that need. During the same timeframe, the Board also should identify the data and other information it would need in order to make an informed judgment about the potential economic consequences of the rule, make a preliminary identification of both relevant baselines and reasonable alternatives to the proposed rule, and consider the potential benefits and costs of the draft rule and the main alternative regulatory approaches.

## 1. The need for the proposed rule and how the proposed rule will meet that need.

The need for the proposed rule arises from the MSRB's regulatory obligations under the Exchange Act to protect investors and foster a free and open market in municipal securities.<sup>23</sup> Ensuring that customer transactions are effected at a fair and reasonable price<sup>24</sup> and making meaningful and useful information about transactions publicly available are two important ways in which the MSRB meets this mandate.

This rule builds on previous MSRB initiatives and addresses an ongoing concern that because retail municipal securities investors have access to less pricing information than other market participants, have a more limited ability to identify the most relevant pricing information, and may encounter significant burdens associated with access and acquisition of relevant information, they may not be able to effectively evaluate the market for their securities or the transaction costs associated with their securities.<sup>25</sup>

Currently, retail customers may use EMMA to gain insight into the market for the securities they trade by viewing recent trade prices in the same or similar securities in similar quantities. However, using EMMA to conduct the relevant pricing analysis requires that customers actively seek out information and make inferences as to which transactions are most relevant. Conducting this type of pricing analysis places a burden on retail customers.

The proposal also addresses the lack of a consistent standard for disclosure of pricing information via customer confirmations for similar types of securities transactions. The SEC has addressed this issue for certain equity securities in Rule 10b-10 and FINRA is proposing similar disclosures for its members engaged in transactions of non-municipal security fixed income securities.

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<sup>23</sup> Securities and Exchange Act of 1934 § 15B(b)(2)(C), 15 U.S.C. 78o-4(b)(2)(C).

<sup>24</sup> See MSRB Rule G-30, on prices and commissions.

<sup>25</sup> See generally SEC Report.

## **2. Relevant baselines against which the likely economic impact of elements of the proposed rule can be measured.**

To evaluate the potential impact of the proposed rule, a baseline, or baselines, must be established as a point of reference. The analysis proceeds by comparing the expected state with the proposed rule in effect to the baseline state prior to the proposed rule taking effect. The economic impact of the proposed rule is measured as the difference between these two states.

Three existing MSRB rules serve as relevant baselines: Rules G-14, on reports of sales or purchases, G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers, and G-30, on prices and commissions. Proposed revisions to Rule G-18 that would establish a best-execution obligation on dealers may also be a relevant baseline.

Rule G-14 requires dealers to report all executed transactions in municipal securities to RTRS within fifteen minutes of the time of trade, with limited exceptions. This information is made public through EMMA. The proposal would require dealers to identify which of its transactions reported to RTRS will serve as a reference transaction, and to disclose both the price of a reference transaction and the difference in price between a reference transaction and the customer trade. The disclosures would only be required for transactions in which the dealer is a party on the same side of the transaction as the customer.

Rule G-15 requires, among other things, dealers to disclose on the confirmation the price of a municipal securities transaction. With respect to agency transactions, the dealer must also disclose on the confirmation the amount of remuneration received from the customer in connection with the transaction.

Rule G-30 provides that dealers acting in a principal capacity may only purchase municipal securities from, or sell municipal securities, to a customer at an aggregate price that is fair and reasonable and requires that dealers exercise diligence in establishing the market value of the securities and the reasonableness of their compensation.

## **3. Identifying and evaluating reasonable alternative regulatory approaches.**

The MSRB recognizes that there are alternatives to the proposed approach that range from taking no action, providing additional information via EMMA,

requiring dealers to disclose information on the customer confirmation other than what is proposed above (including disclosure of markups on riskless principal transactions), requiring disclosure of pricing reference information under alternative parameters, or some combination thereof.

The MSRB could take no action. Under this alternative, retail customers would continue to use EMMA to acquire market information and evaluate the costs associated with their transactions. Retail customers would not be able to ascertain with certainty the specific price paid by its dealer and may, therefore, be relying on less useful information. To address this, the MSRB could develop an internal methodology for identifying a reference transaction and provide this information to the public. The MSRB seeks comments that would help to quantify the existing burdens of accessing market information via EMMA and the degree to which changes to what is currently provided to the public would mitigate or increase these burdens.

The MSRB could require dealers to disclose information other than the price of a reference transaction and the difference in price between a reference transaction and the customer trade. For example, the MSRB could require disclosure of only the price of a reference transaction and not require disclosure of the price differential or the MSRB could require disclosure of the total trade price differential between a reference transaction and the customer transaction in lieu of or in addition to the disclosure of the price differential as proposed.

The MSRB could also require the inclusion of other market information (*e.g.*, prices provided by external pricing services) on the confirmation. The MSRB seeks comments on whether any of these alternatives provide customers with more meaningful and useful information, whether that value of additional information can be quantified, and the degree to which any of these alternatives would be more or less costly to implement.

The MSRB could specify a shorter or longer period during which a reference transaction may take place. For example, an alternative to the same-day threshold could be to limit the disclosure requirement for those principal trades that occur within thirty minutes of the customer trade or extend the time period to beyond one day. The MSRB seeks comments that would support quantification of the relevance of transactions that occur more or less closely in time to the customer transaction and the degree to which a change in the threshold would increase or decrease costs associated with disclosure.

The MSRB could specify an alternative definition of the size that a dealer transaction must be to meet the definition of a reference transaction. For

example, the MSRB could specify that reference transactions are only those dealer transactions that are identical in size to the customer transaction or meet an alternative definition of “similar size” (e.g., 50 percent smaller or 100 percent larger than the customer transaction). The MSRB seeks comments that would support the quantitative evaluation of the degree to which transactions need to be similarly sized to provide meaningful and useful market information and the degree to which a change in the size definition of a reference transaction would increase or decrease costs associated with disclosure.

The MSRB could specify the methodology by which a reference transaction price is determined when the size of a reference transaction is not identical to the size of the customer transaction. As noted above, the FINRA Proposal identifies methodologies for calculating a reference price under a range of scenarios. The MSRB seeks comment on the degree to which particular methodologies are more or less likely to result in a disclosed reference transaction price for municipal securities that is meaningful and useful and whether particular methodologies are more or less costly to implement.

Finally, the MSRB could reduce or increase the size and/or value of customer transactions for which pricing reference information disclosures would be required. Alternative thresholds would provide confirmation disclosures to customers beyond those that transact in retail sizes. These could include providing disclosures to all customers, or to all customers that are not sophisticated municipal market professionals. The MSRB seeks comment on whether the 100 bonds or fewer or bonds in the par amount of \$100,000 or less is an appropriate threshold and the degree to which a change in the threshold would increase or decrease costs associated with disclosure.

Another possible approach would be to require disclosure of the same pricing information, but limited to “riskless principal” trades, which would be consistent with the amendments to Rule 10b-10 that were previously proposed by the SEC.

#### **4. Assessing the benefits and costs, both quantitative and qualitative, of proposal and the main alternative regulatory approaches.**

The MSRB policy on economic analysis in rulemaking addresses consideration of the likely costs and benefits of the rule with the draft amendments fully implemented, against the context of the economic baselines discussed above.

The MSRB is able to identify some data to help quantify the economic effects of the proposal. For example, trade data from EMMA provides some insight



into the portion of retail-size trades in municipal securities to which a potential disclosure requirement might apply. However, additional information will be necessary to fully assess the economic effect of the proposal.

**Benefits**

The proposal is intended to provide additional information to retail investors and reduce the burden on retail investors for obtaining relevant information for purposes of the investor's understanding of the market for the traded security. The MSRB expects that the proposal will result in important benefits for investors who are customers in retail-size transactions. The MSRB expects that the proposal will promote a free and open market.

While EMMA has generally helped to make pricing information available and more accessible to the market, such information is generally directly beneficial only to those who actively seek it out and requires investors to make inferences about transactions. By requiring dealers acting in a principal capacity to disclose additional information to customers on the customer confirmation, the proposed rule would provide additional useful information and reduce the burden currently placed upon retail investors to actively search the EMMA database.

**Costs**

Our analysis of the potential costs does not consider all of the costs associated with the proposal, but instead focuses on the incremental costs attributable to it that exceed the baseline state. The costs associated with the baseline state are, in effect, subtracted from the costs associated with the draft rule to isolate the costs attributable to the incremental requirements of the proposal.

The proposal would likely require firms to modify their operational systems to identify reference transactions and provide the required disclosure on customer confirmations. For many firms, the reprogramming of existing systems may be costly. The MSRB seeks comments on the anticipated costs of such changes.

The MSRB is also requesting comments on whether the proposal could have unintended impacts on market behavior including, but not limited to: firms holding fewer bonds in inventory, firms holding more bonds in inventory, or dealers reducing service in retail-size trades.

Finally, the MSRB recognizes that, in some cases, additional information may cause customer confusion. The MSRB seeks comment on how this proposal could best ensure that customers receive relevant and useful information.

**Effect on Competition, Efficiency, and Capital Formation**

One of the likely effects of the proposal is that competition between dealers will be enhanced. Retail customers will have information that will allow them to make more informed choices about which dealers to use for future transactions, incentivizing dealers to offer competitive prices in retail transactions.

It is possible that the costs associated with the requirements of the proposal relative to the baseline may lead some dealers to reduce services to retail investors. In some cases, the costs could lead smaller dealers to consolidate with larger dealers or to exit the market.

The MSRB seeks public comment on the following questions, as well as any other comments on this topic, to assist it in determining whether to proceed with the development of a proposed pricing reference disclosure requirement for dealers. The MSRB particularly welcomes statistical, empirical, and other data from commenters that may support their views and/or support or refute the views or assumptions or issues raised in this request for comment.

1. Would the proposed disclosures provide investors with greater transparency into the compensation of their brokers or the costs associated with the execution of their municipal securities trades? Would the proposed disclosures help ensure investors receive fair and reasonable prices? What are the other potential benefits of the proposal?
2. What costs would this proposal impose on firms, including the cost of reprogramming the systems that create customer confirmations? Would such costs be mitigated by the coordinated approach of the MSRB and FINRA to this topic?
3. For what time period should the dealer's trades be disclosed? Is the same trading day standard appropriate in light of the objectives, costs and benefits of the proposal?
4. For which transactions should pricing reference disclosures be made?
  - Is it appropriate to provide that a dealer is only obligated to disclose pricing reference information when the customer trade is likely to be a retail trade? If so, should retail be defined by reference to the trade size, as in the proposal, or by some other standard?
  - Should there be any exclusions for certain types of transactions, notwithstanding the fact that they are retail-size transactions? For example, should the proposed disclosures not be required for new issue trades?

5. What are the viable alternatives to the proposal?
  - In lieu of the proposed disclosure of pricing reference information, should the MSRB require dealers to disclose their “markups” on “riskless principal” transactions as in the SEC’s recommendation? If so, how could “riskless principal” transactions be defined to minimize market participant concerns?
  - Would the disclosure of additional information on EMMA meet some or all of the objectives of this proposal? If so, what information should be disclosed?
  - Is there a more principles-based approach that would achieve the objectives of the proposal?
6. To what extent, if any, do dealers already provide or make available such information or similar information to customers in any format?
7. Are there any situations in which pricing reference information that would normally require disclosure under the proposal should not require such disclosure?
8. When a firm executes multiple municipal securities transactions as principal, what should be the appropriate methodology or methodologies to use in determining the reference transaction price and differential to be disclosed on the confirmation? Are any of the methodologies referenced in this notice (*e.g.*, closest in time proximity to the customer trade or last in, first out) appropriate? Are there other methodologies that may be more appropriate?
9. Would the required disclosures encourage dealers to take actions to avoid making the proposed disclosures? For example: selling from inventory; taking a portion of securities from certain trades into inventory to avoid meeting the “reference transaction” definition; or holding securities until the relevant time period requiring disclosure has lapsed? If so, what effect might such actions have on the market? Would the risks associated with holding such securities in inventory weigh significantly against such actions?
10. For dealers with multiple market participant identifiers (MPIDs) registered to the same legal entity, what are the operational issues and associated costs with the proposal?
11. What information should be required to be disclosed on the customer confirmation?
  - Should the price differential between the customer’s trade price and a reference transaction be disclosed as a percentage of par as in the proposal, or on a total dollar amount basis (*i.e.*, a differential that calculates the total dollar amount differential based on the number of bonds purchased or sold by the customer)? Should both be required to be disclosed? Is

- there a better alternative to requiring the disclosure of the price differential?
- Should a reference transaction for which a dealer must disclose pricing information be more limited or more expansive in trade size? For example, should the proposal be limited to require only the disclosure of information pertaining to trade sizes that are identical to, or within a specified range as compared to, the customer trade size? Are the sizes that would currently require disclosure under the proposal over-inclusive or under-inclusive? For example, under the proposal, pricing information for a single trade that would otherwise meet the reference transaction definition, but that is in a trade size slightly below the customer trade size, would not require disclosure (*e.g.*, the customer purchased 100 bonds from the dealer, and the dealer purchased 95 of those same bonds on the same trading day). How probative would these disclosures be for retail investors?
  - Should pricing information also be disclosed for transactions in which the dealer transacted on the side opposite the customer's side of the transaction (*e.g.* transactions in which the dealer sold the same securities to both the customer and another party)?
12. Should pricing information for a reference transaction between affiliates be required to be disclosed, as is currently the case under the proposal, or should the required disclosures be limited to transactions with other dealers or customers?
  13. Would a requirement to disclose pricing reference information on the confirmation cause any problematic delays in sending the confirmation to a customer?
  14. Do the disclosures have the potential to mislead or confuse investors to a degree that cannot be remedied by education, explanations or descriptions supplementing the disclosures?

November 17, 2014

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## Text of Draft Amendments<sup>26</sup>

### Rule G-15: Confirmation, Clearance, Settlement and Other Uniform Practice Requirements with Respect to Transactions with Customers

(a) *Customer Confirmations.*

(i) At or before the completion of a transaction in municipal securities with or for the account of a customer, each broker, dealer or municipal securities dealer shall give or send to the customer a written confirmation that complies with the requirements of this paragraph (i):

(A) – (E) No change.

(F) Pricing reference information. If the broker, dealer or municipal securities dealer is effecting a transaction as principal for 100 bonds or fewer or bonds in a par amount of \$100,000 or less, the confirmation shall include:

(1) the price for any reference transaction (as defined in paragraph (a)(vi)(I) of this rule); and

(2) the difference in price between the reference transaction (as defined in paragraph (a)(vi)(I) of this rule) and the customer trade, expressed as a percentage of par.

(ii) – (v) No change.

(vi) Definitions. For purposes of this rule, the following terms shall have the following meanings:

(A) – (H) No change.

(I) The term “reference transaction” is a transaction in which the broker, dealer or municipal securities dealer transacts: (1) in a principal capacity; (2) with a third party to purchase or sell municipal securities; (3) in the same security as the customer; (4) on the same side of the transaction as the customer (as purchaser or seller); (5) on the same date as the customer transaction; and (6) in a single trade amount that equals or exceeds the size of the customer transaction or in a trade amount that, when combined with one or more other transactions that meet the requirements of clauses (1) through (5) of this paragraph, equals or exceeds the size of the customer transaction.

(vii) – (viii) No change.

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<sup>26</sup> Underlining indicates new language.

(b) – (g) No change.