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Request for Comment

Comment Deadline

November 20, 2015

[Original deadline
extended to
December 11, 2015
on October 20, 2015]

Category

Uniform Practice;
Market Transparency

Affected Rules

[Rule G-15](#)

Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers

[Comment deadline extended on October 20, 2015.
[See Notice 2015-19](#)]

Overview

The Municipal Securities Rulemaking Board (MSRB) is seeking comment on draft rule amendments to require brokers, dealers, and municipal securities dealers (“dealers”) to disclose the mark-up or mark-down (collectively “mark-up”) on retail customer confirmations for specified principal transactions. The MSRB and the Financial Industry Regulatory Authority (FINRA) have been engaged in ongoing dialogue regarding potential rulemaking in this area. The FINRA Board of Governors has authorized the publication of a regulatory notice requesting comment on a revised FINRA proposal to require firms to disclose pricing information on customer confirmations for trades in corporate and agency securities with non-institutional customers, where the firm’s principal trade and the customer trade both occur on the same trading day.¹ The MSRB, in addition to its mark-up disclosure proposal, which is based on a recommendation in the Securities and Exchange Commission’s 2012 Report on the Municipal Securities Market (“SEC Report”), is broadly seeking comment on alternatives. These include the MSRB’s previous proposal to require dealers to provide pricing reference information on retail customer confirmations

¹ See Letter from FINRA to Executive Officers, Update: FINRA Board of Governors Meeting (July 9, 2015), available at: <http://www.finra.org/industry/update-finra-board-governors-meeting-13>.



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for same-day principal transactions in municipal securities,² with several possible modifications to that proposal as discussed below.

Comments should be submitted no later than November 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 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.³

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

Background

The MSRB is charged by Congress to foster a free and open municipal securities market and to protect investors and the public interest.⁴ Under this mandate, the MSRB has adopted a set of rule provisions that address dealer pricing and compensation, as well as transaction confirmations. MSRB Rule G-30, on prices and commissions, provides that a dealer may only purchase municipal securities for its own account from a customer, or sell municipal securities for its own account to a customer, at an aggregate price (including any mark-up) that is fair and reasonable. For such principal transactions, the total transaction price to the customer must bear a reasonable relationship to the prevailing market price of the security at the time of the customer transaction, and the mark-up, as part of the aggregate price, must also be fair and reasonable.⁵ For purposes of Rule G-30, the mark-up is calculated based on the inter-dealer market price prevailing at the time of the customer transaction.⁶ When executing a transaction on an agency basis, the

² See Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations, MSRB Notice 2014-20 (Nov. 17, 2014) (“Notice 2014-20”).

³ 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. Commenters should only submit information that they wish to make available publicly.

⁴ *E.g.*, Securities and Exchange Act of 1934 § 15B(b)(2)(C), 15 U.S.C. 78o-4(b)(2)(C).

⁵ Rule G-30, Supplementary Material .01(c) & (d).

⁶ Rule G-30, Supplementary Material .01(d).

commission or service charge must not be in excess of a fair and reasonable amount.⁷ Whether effecting a transaction on a principal or agency basis, dealers must exercise diligence in establishing the market value of the security and the reasonableness of their compensation.⁸ Under MSRB Rule G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers, dealers are required to disclose on the customer confirmation transaction-based remuneration received from the customer when the dealer acts as agent. There is, however, currently no comparable disclosure requirement under SEC or MSRB rules when the dealer acts as principal.

In 2012, the Securities and Exchange Commission (SEC) issued a report in which it broadly examined the municipal securities market, including regulatory structure, market structure and market practices.⁹ The report expressed concern about transparency, particularly with respect to pricing and transaction costs for retail customers.¹⁰ The report noted that virtually all customer transactions in the municipal securities market are executed by dealers acting in a principal capacity.¹¹ The report also expressed concern regarding the dichotomy between current dealer remuneration disclosure requirements for transactions executed in an agency versus principal capacity when, at least in the case of “riskless principal” transactions, the SEC viewed the mark-up to be “readily determinable.”¹² The report recommended that the MSRB consider 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.¹³ The report also recommended that the MSRB consider requiring dealers to disclose to customers, on confirmations for riskless principal transactions, the amount of any mark-up.¹⁴

⁷ Rule G-30(b)(ii).

⁸ Rule G-30, Supplementary Material .01(a).

⁹ See U.S. Securities and Exchange Commission, Report on the Municipal Securities Market (July 31, 2012) (“SEC Report”).

¹⁰ See *id.* at 115-116, 123-126.

¹¹ See *id.* at 113 and 148.

¹² See *id.* at 148-149.

¹³ See *id.* at 147-148.

¹⁴ See *id.* at 148-149.

SEC Chair Mary Jo White later publicly called for mark-up disclosure on riskless principal transactions and stated that the SEC would coordinate with the MSRB and FINRA in pursuit of such a standard.¹⁵ Each of the other SEC Commissioners also has publicly urged the MSRB to consider adopting a mark-up disclosure, or similar, requirement for some category of principal transactions, at least to include “riskless principal” transactions.¹⁶ In recent

¹⁵ See Mary Jo White, Chair, SEC, Remarks at the Economic Club of New York, Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors (June 20, 2014) available at <http://www.sec.gov/News/Speech/Detail/Speech/1370542122012> (“[T]o help investors better understand the cost of their fixed income transactions, [the SEC] will work with FINRA and the MSRB in their efforts to develop rules by the end of this year regarding disclosure of markups in ‘riskless principal’ transactions for both corporate and municipal bonds. . . . Markups – the dealer’s compensation – for these transactions can be readily identified because they are based on the difference in prices on the two contemporaneous transactions, which already must be reported promptly to FINRA and the MSRB for public posting after the trade.”)

¹⁶ See Luis A. Aguilar, Commissioner, SEC, Statement on Making the Municipal Securities Market More Transparent, Liquid, and Fair (Feb. 13, 2015) available at <http://www.sec.gov/news/statement/making-municipal-securities-market-more-transparent-liquid-fair.html> (commending the MSRB on its transparency initiatives and urging additional disclosure, stating that “both FINRA and the MSRB should consider implementing a true markup disclosure requirement”); Michael S. Piwowar, Commissioner, SEC, Remarks at the 2014 Municipal Finance Conference presented by The Bond Buyer and Brandeis International Business School (Aug. 1, 2014) available at <http://www.sec.gov/News/Speech/Detail/Speech/1370542588006> (“The time has come to require dealers to disclose markups and markdowns on all riskless principal bond transactions on customer confirmations”); Michael S. Piwowar, Commissioner, SEC, Remarks at University of South Carolina and UNC-Charlotte 4th Annual Fixed Income Conference (Apr. 21, 2015) available at <http://www.sec.gov/news/speech/remarks-usc-unc-fourth-annual-fixed-income-conference.html> (“Shortly after assuming my role as a commissioner at the SEC, I gave a speech calling for common-sense reforms to the municipal and corporate bond markets, including the disclosure of markups and markdowns on riskless principal transactions. In August of last year I reiterated that call”); Daniel M. Gallagher, Commissioner, SEC, Remarks at Municipal Securities Rulemaking Board’s 1st Annual Municipal Securities Regulator Summit (May 29, 2014) available at <http://www.sec.gov/News/Speech/Detail/Speech/1370541936387> (“Disclosure of the markup or markdown in riskless principal transactions would enable customers to assess the fairness of the execution prices. I encourage the MSRB to review whether amendments to Rule G-15 to accomplish such disclosure would be appropriate.”); Daniel M. Gallagher, Commissioner, SEC, A Watched Pot Never Boils: the Need for SEC Supervision of Fixed Income Liquidity, Market Structure, and Pension Accounting (Mar. 10, 2015) available at <http://www.sec.gov/news/speech/031015-spch-cdmg.html> (“[A] dealer acting as a principal is not required to disclose its markup on a confirmation, even for a riskless principal transaction. Given that ‘riskless principal’ is basically just a fancy name for ‘agency,’ there is no real reason to perpetuate this dichotomy”); Kara M. Stein, Commissioner, SEC, Keynote

months, SEC Commissioners have renewed, and even strengthened, those calls.¹⁷

In November 2014, the MSRB issued Notice 2014-20, in coordination with FINRA, requesting comment on a proposal to require dealers to provide pricing reference information on retail customer confirmations (the “pricing reference proposal”). Under that proposal, for same-day, retail-sized principal transactions, dealers would be required to disclose on the customer confirmation the price to the dealer in a “reference transaction” and the differential between the price to the dealer and the price to the customer. A reference transaction would generally be a transaction in which the dealer, as principal, purchases or sells the same security that is the subject of the confirmation on the same day as the customer trade and on the same side of the transaction as the customer. Additionally, to be a reference transaction, it must be in a trade amount that individually, or when combined with one or more other dealer transactions, equals or exceeds the size of the customer transaction.

The pricing reference proposal had dual goals: to provide retail investors with increased transparency into the market for their security and to provide them with increased transparency into their transaction costs. As the MSRB explained in the notice, the pricing reference proposal was designed to be a reasonable alternative to a mark-up disclosure requirement. The notice stated that while the differential between the reference price and the customer price “is not necessarily the same as a markup, it can provide the investor increased price transparency and significant insight into the market

Address at Columbia Law School Conference on Current Issues in Securities Regulation: The ‘Hot’ Topics (Nov. 21, 2014) available at <http://www.sec.gov/News/Speech/Detail/Speech/1370543515397> (discussing “areas where regulators should move forward” and stating that “[d]espite the transaction information being readily available on EMMA, investors do not receive disclosure on their confirmations showing the transaction costs that they pay when they buy or sell a municipal security in a principal transaction”).

¹⁷ Luis A. Aguilar, Daniel M. Gallagher, Kara M. Stein and Michael S. Piwovar, Commissioners, SEC, Statement on Edward D. Jones Enforcement Action (Aug. 13, 2015) available at <http://www.sec.gov/news/statement/statement-on-edward-jones-enforcement-action.html> (“The Commission’s recent enforcement action against Edward D. Jones involving the offer and sale of municipal bonds to retail investors highlights the need for clear rules requiring the disclosure of mark-ups and mark-downs. We encourage the Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB) to complete rules mandating transparency of mark-ups and mark-downs, even in riskless principal trades. If not, we believe the Commission should propose rules to address this important issue.”)

for the security,” and “an analysis of this differential may also achieve many of the regulatory objectives of a markup disclosure requirement.”¹⁸ In addition to this possible substitute for mark-up disclosure, the notice identified mark-up disclosure as an alternative to the pricing reference proposal and sought comment as to that alternative, though a mark-up disclosure requirement was not the primary focus of the notice.

In response to the notice, several commenters expressed the view that mark-up disclosure on riskless principal transactions could achieve similar or greater benefits than the pricing reference proposal but at significantly lower cost, particularly if the most important goal of the pricing reference proposal was transparency regarding transaction costs.¹⁹ Some commenters expressed the view that the disclosure of mark-ups on riskless principal trades most closely identifies dealer compensation, whereas disclosure of the difference in price between dealer and customer trades executed in the same security at different points in time on the same day would inaccurately suggest that such differences in price are always equivalent to the mark-up.

Based on careful consideration of all of the comments received on the pricing reference proposal, the MSRB believes, at this juncture, that a mark-up disclosure requirement may have comparable or greater benefits for retail investors in the municipal securities market than a pricing reference information disclosure requirement, with fewer costs to the market as a whole. For example, under the mark-up disclosure proposal, the risk of customer confusion and the potential to misinterpret the disclosures may be substantially decreased because the term “mark-up” is commonly understood as an indication of dealer compensation.

Additionally, because dealers are already under a regulatory obligation to ensure that their mark-ups are fair and reasonable, and to determine the prevailing market price in connection with their establishment of a fair price in their customer transactions, dealers should already have processes and systems in place to determine their mark-ups. Dealers would be required to disclose their mark-ups to customers, rather than utilize potentially

¹⁸ Notice 2014-20, at 7.

¹⁹ These commenters included: the Securities Industry and Financial Market Association, Morgan Stanley Smith Barney, LLC and Wells Fargo Advisors, LLC. Three commenters, Bernardi Securities, Financial Services Roundtable and Hilliard Lyons, favored limiting any disclosure (whether mark-up or pricing reference information) to “riskless” principal transactions.

complicated methodologies to determine which of potentially many transactions should be used as a comparator for purposes of disclosing to the customer pricing reference information. Also, as discussed below, mark-up disclosure is less likely to disrupt the generation for customers of intraday confirmations. The MSRB believes that a mark-up disclosure requirement, as proposed here, would be complementary to a number of transparency and retail-investor focused initiatives the MSRB has undertaken in recent years.²⁰ The MSRB is seeking, from investors, dealers, other market participants and all other interested persons, comment focused on a mark-up disclosure requirement for specified principal transactions, including those that could be considered “riskless.” The MSRB is also seeking comment on all other aspects of this mark-up disclosure proposal and seeks, in particular, comments about likely costs and benefits.

In addition, after carefully considering the comments received on Notice 2014-20, the MSRB is seeking comment as to potential modifications to its pricing reference proposal, which may be considered as an alternative to this mark-up disclosure proposal.

Summary of Draft Amendments to Rule G-15

Mark-up Disclosure

In summary, the draft amendments to Rule G-15 would require disclosure on retail customer confirmations of:

- the mark-up for principal transactions when the dealer transacts in a municipal security in a specified trade size on the same side of the market as the customer within two hours of the customer’s transaction; and
- a hyperlink and uniform resource locator (“URL”) address to the Security Details page for the customer’s security on EMMA, along

²⁰ See MSRB Long-Range Plan for Market Transparency Products (Jan. 27, 2012); Concept Release on Pre-Trade and Post-Trade Pricing Data Dissemination through a New Central Transparency Platform, MSRB Notice 2013-14 (July 31, 2013); Request for Comment on More Contemporaneous Trade Price Information Through a New Central Transparency Platform, MSRB Notice 2013-02 (Jan. 17, 2013); SEC Approves MSRB Rule G-18 on Best Execution of Transactions in Municipal Securities and Related Amendments to Exempt Transactions with Sophisticated Municipal Market Professionals, Notice 2014-22 (Dec. 8, 2014); MSRB Creates Online Education Center to House Digital Resources About the Municipal Market, Press Release (July 28, 2014). *See also* SEC Report, at 117, 141 (noting MSRB transparency initiatives).

with a brief description of the type of information available on that page.

The amendments additionally would require inclusion on all customer confirmations of the time of trade execution, accurate to the nearest minute.

Specified Principal Transactions

Under the draft amendments, dealers generally would be required to disclose the mark-up on retail customer confirmations for principal transactions when they transact on the same side of the market²¹ as the customer in the customer's municipal security in one or more transactions that in the aggregate meet or exceed the size of the customer transaction. The disclosure of the mark-up would be required only where the dealer's same-side of the market transaction occurs within the two hours preceding or following the customer transaction.²² The MSRB is not proposing to use this timeframe to define a "riskless principal" transaction; rather, the MSRB believes this timeframe would be sufficient to cover transactions that could be considered "riskless principal" transactions under any current market understanding of the term.

Mark-up Calculation and the Prevailing Market Price

Under the mark-up disclosure proposal, and consistent with existing MSRB fair-pricing rules, the mark-up to be disclosed on the customer confirmation would be the difference between the price to the customer and the prevailing market price for the security. Presumptively, the prevailing market

²¹ To illustrate, a dealer is on the same side of the market as a customer who purchases securities when the dealer also purchases securities. Thus, for example, when a dealer purchases securities and then sells those same securities to a customer, the dealer and customer have traded on the same side of the market.

²² A preliminary review of MSRB trade data for purposes of seeking comment suggests that under the MSRB's mark-up disclosure proposal, mark-up disclosure would be provided for at least half of all retail-sized customer trades in the secondary market. Retail-sized customer trades in the secondary market were defined, for purposes of this data analysis, as transactions with customers for \$100,000 par amount or less (excluding trades reported as list offering price transactions). The MSRB is not, at this juncture, proposing to require disclosures for same-side of the market transactions made during the same trading day because it currently believes that the additional costs and complexities associated with the broadening of this time trigger to a full-day time period might not be justified. As noted below, however, the MSRB seeks comment on this matter and, more broadly, seeks comment as to whether mark-up disclosures should be required on all principal transactions with retail customers, irrespective of whether the dealer has a same-side of the market transaction in the customer's security.

price for the customer's security for purposes of calculating the mark-up would be established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with applicable MSRB rules (*e.g.*, Rule G-18). While dealers, to comply with their fair-pricing obligations, already have processes and systems in place that are designed to ensure that their mark-ups on all principal transactions are fair and reasonable, the MSRB is currently proposing to require disclosure of the mark-up only under the parameters described herein, as the prevailing market price and resultant mark-up on the customer's security should be more readily determinable under these circumstances.²³ As detailed in the questions at the conclusion of this notice, the MSRB specifically seeks comment on the appropriate strength of the presumption described above, including whether it should be rebuttable or conclusive when the dealer, after receiving an order for a security, executes a transaction to offset the customer's purchase or sale of the security.

Disclosure Format

The disclosed mark-up would be required to be expressed both as a total dollar amount and as a percentage of the principal amount of the customer transaction.²⁴ The MSRB believes that, when expressed in these ways, disclosure of the mark-up would assist retail customers in understanding and comparing their transaction costs across their other municipal bond transactions to better evaluate the fairness of their transaction costs.

Retail Customers in the Secondary Market

Disclosure of the mark-up would be required for transactions for an account other than an "institutional account," as defined in MSRB Rule G-8(a)(xi).²⁵

²³ The MSRB understands that some dealers currently provide the amount of their mark-ups to customers upon request or disclose their mark-ups on customer confirmations.

²⁴ For example, if a customer purchased a quantity of 50 bonds (\$50,000 par amount) at a price of 102 when the prevailing market price for the bonds was 100, the disclosure would indicate that the mark-up on the transaction was \$1,000 (2% of \$50,000 par amount) and that it equates to a 2% mark-up on the principal amount of the customer's bonds.

²⁵ Rule G-8(a)(xi) defines the term "institutional account" as

the account of (i) a bank, savings and loan association, insurance company, or registered investment company; (ii) an investment adviser registered either with the Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or (iii) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least \$50 million.

Additionally, to focus the proposal on the secondary market, the draft amendments would exclude transactions in new issue securities effected at the list offering price by members of the underwriting group²⁶ from the requirements of the mark-up disclosure proposal. Specifically, mark-up disclosure would not be required for a transaction that is a “list offering price transaction” as defined in paragraph (d)(vii) of Rule G-14 RTRS Procedures.²⁷ As defined therein, “list offering price transaction” means a primary market sale transaction executed on the first day of trading of a new issue by a sole underwriter, syndicate manager, syndicate member or selling group member at the published list offering price for the security. Such transactions are executed at the same publicly announced price to investors and offering documents for new issues already provide disclosure regarding underwriting fees and selling concessions.²⁸

“Look Through” for Specified Trading Structures

The MSRB is aware that some dealers, on an exclusive basis, acquire municipal securities from, or sell municipal securities to, an affiliate that holds inventory in such securities and transacts with other market participants. Under this inventory-affiliate model, the dealer would be required to “look through” the transaction with the affiliated dealer and substitute the affiliate’s trade with the third party from whom it purchased or to whom it sold the security to determine whether disclosure of the mark-up would be required.²⁹ This “look through” is designed to ensure that the

²⁶ Underwriting group members include sole underwriters, syndicate managers, syndicate members, selling group members or dealers that have entered into long-term marketing arrangements with other dealers that serve in the syndicate or selling group relating to purchases and re-sales of new issue securities. *See infra* n. 27.

²⁷ Effective no later than May 23, 2016, the list offering price transaction definition will be amended to mean a primary market sale transaction executed on the first day of trading of a new issue by a sole underwriter, syndicate manager, syndicate member, selling group member, or distribution participant to a customer at the published list offering price for the security. As used in the amended “list offering price transaction” definition, the term “distribution participant” will mean a dealer that has agreed to assist an underwriter in selling a new issue at the list offering price. *See* Release No. 34-75039 (May 22, 2015), 80 FR 31084 (June 1, 2015) (File No. SR-MSRB-2015-02).

²⁸ Due to the limited nature of this exception, if a member of the underwriting group makes a sale at a price other than the list offering price, *see* In the Matter of Edward D. Jones & Co., L.P., 2015 WL 4760902 (Aug., 13, 2015), the exception would not apply.

²⁹ For example, Dealer 1 and Dealer 2 are affiliates. All municipal securities are held in inventory at Dealer 1 while all principal transactions with retail customers are executed through Dealer 2. Dealer 1 and Dealer 2 have an agreement under which Dealer 2 will fill all of its orders for municipal securities through securities held at Dealer 1. Thus, in order to

disclosed mark-up is a more accurate indication of the compensation paid by the customer when affiliated dealers effectively function as a single entity for purposes of executing the retail customer's transaction. Further, in the absence of a "look through," the dealer would be required to disclose the mark-up on virtually all retail customer transactions (because the trade between these entities occurs very close in time to the associated customer transaction).

Functionally Separate Trading Desks

Absent additional guidance regarding the mark-up disclosure requirement, a dealer with multiple principal trading desks would ordinarily look across all of its trading desks to determine whether a same-side of the market transaction was executed in the customer's security within two hours of the customer trade.³⁰ However, the MSRB understands that under certain dealer structures, trading desks may operate independently of one another such that one trading desk may have no knowledge of the transactions executed by another trading desk within the same dealer. Under such structures, mark-up disclosure would not be required for a customer transaction if the dealer can establish that: (i) the customer transaction was executed by a principal trading desk that is functionally separate from the principal trading desk that executed the dealer's same-side of the market transaction;³¹ and (ii) the functionally separate principal trading desk through which such same-

execute a transaction in municipal securities for a retail customer, there will always be an intermediate trade between Dealer 1 and Dealer 2. Under the MSRB's mark-up disclosure proposal, Dealer 2 must "look-through" the intermediate trade between Dealer 1 and Dealer 2, such that a disclosure to a retail customer of Dealer 2 would require an analysis of whether Dealer 1 executed a same-side of the market trade in the customer's security within two hours of the customer trade.

³⁰ Only purchases or sales that are required to be reported to the MSRB's Real-Time Transaction Reporting System ("RTRS") (*i.e.*, purchase-sale transactions in which there is a transfer of ownership) would trigger an obligation to disclose the mark-up. Because an internal movement of securities between a dealer's principal trading desks is not a reportable transaction under MSRB Rule G-14, a dealer would not be required to disclose the mark-up to a customer based on an internal movement of securities between principal trading desks made within two hours of the customer trade. For example, if a dealer's "institutional" trading desk acquires 100 bonds in XYZ securities at 10:00 a.m., and the dealer's "retail" trading desk within the same firm sells those bonds to a retail customer at 10:10 a.m., the internal movement of XYZ securities from the institutional trading desk to the retail trading desk seconds before the 10:10 a.m. sale to the retail customer would not trigger the obligation to disclose the mark-up to the customer. Rather, the occurrence of the dealer's initial acquisition of XYZ securities by the institutional trading desk at 10:00 a.m. (within two hours of the customer sale) would obligate the dealer to disclose the mark-up.

³¹ This might be demonstrated, for example, through the firm's policies and procedures.

side of the market transaction was executed had no knowledge of the retail customer transaction. Excepting such transactions is consistent with the objective of the proposal to have sufficient parameters to cover transactions that could be considered “riskless principal” transactions.

Security-Specific Link to EMMA and Time of Execution

Lastly, a dealer would be required to provide two additional data points on the customer confirmation, even if the dealer would not be required to disclose its mark-up. First, on all customer confirmations for non-institutional accounts, including those for agency transactions, dealers would be required to provide a hyperlink and URL address to the Security Details page for the customer’s security on EMMA,³² along with a brief description of the type of information available on that page.³³ Second, without exception, dealers would be required to disclose the time of execution for a customer’s trade, accurate to the nearest minute. Currently, under Rule G-15(a)(i)(A)(2), a dealer must either disclose this time of execution or provide the customer with a statement that the time of execution will be furnished upon written request of the customer. The MSRB’s current proposal would essentially delete the option to provide this information upon request.

The MSRB believes that the provision of a security-specific link to EMMA on retail customer confirmations, together with the time of trade execution, would provide retail customers a comprehensive view of the market for their security, including the market as of the time of their trade. It also reduces the risk that a customer may focus exclusively on dealer compensation to the detriment of other relevant considerations. Additionally, the promotion of

³² The MSRB is in the process of developing a more succinct EMMA URL for direct access to a security’s Security Details page on EMMA. While current URLs will continue to work to avoid potential disruption for persons with existing page-specific bookmarks or direct links to EMMA pages, the MSRB believes that the creation of an additional more succinct link, which may be used in connection with this proposed disclosure, would be more intuitive and would decrease the number of characters used to make the disclosure on a customer confirmation.

³³ While the proposal would require this disclosure only on customer confirmations for non-institutional accounts, dealers would be free to provide it voluntarily on all customer confirmations, including those for institutional accounts. The MSRB also notes that, for dealers that currently seek to satisfy their obligation to provide a copy of the official statement to customers under Rule G-32(a)(iii) by notifying customers of the availability of the official statement through EMMA, the provision of a single link to the appropriate Security Details page on EMMA would satisfy both the Rule G-32(a)(iii) obligation and the obligation proposed here to provide a link on the confirmation; provided, that the hyperlink and URL address is accompanied by the information required under Rule G-32(a)(iii) as well as the MSRB’s mark-up disclosure proposal.

easier access to EMMA may lead a customer to learn more about the market for the security and assist the customer in understanding any mark-up disclosure received in the context of this market. Even in instances in which the mark-up would not be required to be disclosed to customers, the MSRB believes that the inclusion of a security-specific link to EMMA on retail customer confirmations and the time of execution on all customer confirmations would increase market transparency at relatively low cost to the industry.

Economic Analysis of the Mark-up Disclosure Proposal

1. The need for the draft amendments to Rule G-15 and how they will meet that need.

The need for the draft amendments arises from the MSRB's regulatory obligations under the Securities and Exchange Act of 1934 to protect investors and foster a free and open market in municipal securities.³⁴ One of the important ways in which the MSRB meets this mandate is by ensuring that investors have access to the information necessary to make informed choices and foster competition among dealers.

Specifically, the draft amendments address the need for retail customers to have access to information about transaction costs when their dealers act in a principal capacity³⁵—similar to the information provided to municipal securities investors under Rule G-15 when their dealers act in an agency capacity³⁶ and to the information provided to individuals investing in other types of securities under SEC Rule 10b-10.³⁷ Requiring that dealers disclose their mark-up on retail customer confirmations for specified principal transactions may allow retail customers to participate more fully in the market and encourage competition that could result in lower transaction costs for their purchases and sales of municipal securities.

³⁴ Securities and Exchange Act of 1934 § 15B(b)(2)(C), 15 U.S.C. 78o-4(b)(2)(C).

³⁵ A review of MSRB trade data for the third quarter of 2014 shows that approximately 85 percent of the retail-sized transactions (less than \$100,000) that dealers engage in, are conducted on a principal basis.

³⁶ See MSRB Rule G-15(a)(i)(A)(6)(f).

³⁷ See Rule 10b-10(a)(2)(ii).

The MSRB recognizes that prices—and the dealer compensation/transaction cost component of those prices—may be fair and reasonable,³⁸ but still higher than they might be in an even more competitive market where customers have more information about prices. Municipal securities dealers may be more likely to seek to reduce mark-ups, ensure that mark-ups are fair and reasonable and compete with other dealers on the basis of transaction costs if investors have more insight into those costs. Multiple studies cited in the SEC Report³⁹ showing that retail municipal securities investors pay higher transaction costs than institutional investors or investors in other asset classes, and attributing these differences, in part, to a lack of information, support the potential benefit of additional disclosure.

Additionally, the MSRB believes that providing investors with more information about those costs would improve investor confidence that prices are fair and reasonable and could make the enforcement of Rule G-30 more efficient.

Although including this information on customer confirmations means that investors would receive the disclosure after a transaction is complete, the MSRB believes the draft amendments may, nonetheless, address the need articulated above through at least three mechanisms. First, dealers may seek to reduce transaction costs to maintain and strengthen customer relationships. Second, transaction costs for future trades may be reduced if the disclosure prompts investors to request additional information about transaction costs from their dealers. Third, if an investor believes that a disclosed mark-up is higher than he or she might have received from another

³⁸ In addition to the level of transaction costs, there are other factors that may affect whether the price received by a customer is fair and reasonable, including the market value of the security. The requirement in the draft amendments that dealers include a hyperlink and URL address to the Security Details page for the customer's security on EMMA may offer customers easier access to relevant pricing information. The MSRB's pricing reference proposal (Notice 2014-20) focused more directly on the need for investors to have more insight into the market value being bought or sold and offered an alternative approach to providing customers with access to relevant information.

³⁹ See SEC Report, *supra* n. 9, at 123. See, also, Lawrence E. Harris and Michael S. Piwowar, *Secondary Trading Costs in the Municipal Bond Market*, *Journal of Finance*, 61(3), (June 2006) ("Harris and Piwowar, *Secondary Trading Costs*"), at 1379 and Amy K. Edwards, Lawrence E. Harris and Michael S. Piwowar, *Corporate Bond Market Transaction Costs and Transparency*, *Journal of Finance*, 62(3), (June 2007) ("Edwards, Harris and Piwowar, *Corporate Bond Market Transaction Costs*"), at 1437.

dealer, the investor may be incentivized to seek out other dealers offering lower transaction costs for future trades.

The MSRB also believes that requiring dealers to provide on the customer confirmation the time of a trade's execution and a hyperlink and URL address to the Security Details page for the customer's security on EMMA would provide a comprehensive view of the market at the time of the customer's transaction and reduce the risk that investors focus disproportionately on dealer compensation. The promotion of easier access to EMMA in connection with the mark-up disclosure on a customer's confirmation may lead a customer to learn more about the market for his or her security and assist him or her in understanding the disclosure received in the context of this market.

2. Relevant baselines against which the likely economic impact of elements of the draft amendments to Rule G-15 can be considered.

To evaluate the potential impact of the draft amendments, a baseline or baselines must be established as a point of reference in comparison to the expected state with the draft amendments in effect. The economic impact of the draft amendments is generally viewed to be the difference between the baseline and the expected states.

Two existing MSRB rules serve as relevant baselines. Rule G-15, as discussed above, requires dealers to disclose on the confirmation the price of a municipal securities transaction and, for 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 (including any mark-up) that is fair and reasonable. The MSRB assumes that compliance with this rule means that dealers are currently aware of the mark-up associated with their principal transactions.

SEC Rule 10b-10 may also serve as a relevant baseline, particularly for municipal securities dealers who also transact in equity securities on a principal basis. Specifically, Rule 10b-10(a)(2)(ii)(A) requires that, if a broker or dealer, after having received a customer order to buy or sell an equity security, buys or sells that security from another person to offset a contemporaneous sale to or purchase from the customer, then the broker or dealer must disclose on the customer confirmation the difference between

the price to the customer and the dealer's contemporaneous purchase or sale price.

3. Identifying and evaluating reasonable alternative regulatory approaches.

The MSRB recognizes that there are alternatives to the approach proposed under the draft amendments that range from modifying specific parameters of the MSRB's mark-up disclosure proposal to employing significantly different mechanisms for providing relevant information to investors.⁴⁰

The MSRB could make a number of modifications to specific parameters of the mark-up disclosure proposal including, but not limited to the following:

Modifying the time period separating the customer's trade from a dealer's same-side of the market transaction: The disclosure requirement could be narrowed to only riskless principal transactions, expanded to include principal transactions in which the dealer executed a trade in the customer's security on the same side of the market separated by more than two hours from the customer's trade, or expanded to include all principal transactions regardless of whether the dealer executed a trade in the customer's security on the same side of the market at any time.

Narrowing the requirement to only riskless principal transactions would likely simplify the programming required to determine if a transaction requires confirmation disclosure, improve the efficiency of enforcement, and more closely parallel SEC Rule 10b-10. This narrowing, however, would likely reduce the number of trades requiring mark-up disclosure. It may also create incentives for dealers to change their behavior by, for example, delaying transactions that might previously have been undertaken more contemporaneously so that they are no longer (or no longer appear to be) riskless, by filling more orders out of internal inventory, or by promoting greater use by customers of fee-based accounts.

Expanding the requirement to include principal transactions in which the dealer executed a same-side of the market transaction in the customer's security separated by more than two hours from the customer's trade would likely increase the number of trades requiring mark-up disclosure. Such an

⁴⁰ As noted above, in addition to the alternatives described in this section, the MSRB is specifically seeking comment on possible modifications to the MSRB's previous proposal to require dealers to provide pricing reference information on retail customer confirmations for same-day principal transactions in municipal securities.

expansion may require dealers to exercise more subjective judgment in determining the prevailing market price. It also may make programming systems to determine the trades that require a confirmation disclosure more difficult and could, depending on a firm's processes and the length of time used to determine whether a triggering transaction occurred, delay the generation of confirmations.

Expanding the requirement to include all principal transactions regardless of whether or when the dealer executed a same-side of the market transaction in the customer's security would significantly increase the number of customers receiving information on transaction costs. Such a requirement may eliminate the need for dealers to develop any type of matching utility to determine which customers receive disclosure and would allow confirmations to be printed immediately following the customer's transaction.

Modifying the size of the dealer's same-side of the market transaction that would trigger disclosure: The disclosure requirement could be narrowed so that it would only be triggered if the dealer executed a same-side of the market transaction in exactly the same trade size as the customer's trade or broadened so that it would be triggered if the dealer had a trade in the same security of any size.

Narrowing the proposal to only those instances in which a dealer executed a same-side of the market transaction in the exact same trade size would reduce the number of customers receiving disclosure. Broadening the proposal to include those instances in which a dealer had a same-side of the market transaction in the same security regardless of size would increase the number of customers receiving disclosure and would likely eliminate the need for dealers to develop a matching utility based on trade size and would allow confirmations to be printed immediately following the customer's transaction.

Modifying which investors receive mark-up disclosure: The MSRB could require that confirmation disclosure be provided to customers with institutional accounts, in addition to those with non-institutional accounts. Expanding the requirement would increase the number of customers receiving the disclosure but may make the necessary programming changes more challenging if these types of accounts are supported by different systems.

Modifying the form of the disclosure: The MSRB could allow dealers to provide mark-up disclosure on a document included with, but distinct from, the confirmation or online via a link included with the confirmation.

Alternatives to including the mark-up on the front of the confirmation would reduce the likelihood that customers would review the information but may reduce the burden on firms of modifying confirmations.

The MSRB could also consider approaches that differ more significantly from the draft amendments. For example, rather than requiring the disclosure of the mark-up on customer confirmations, the MSRB could require that dealers disclose the difference between the price paid by or received from the customer and a price estimated by a third-party price evaluator. These approaches may be more confusing to investors and create a more significant burden on dealers than what is proposed under the draft amendments.

Rather than disclosing a specific mark-up, the MSRB could require that dealers provide customers with a schedule indicating the range, in percentage terms, of the mark-up applied to certain transactions. This approach would significantly reduce the burden on dealers and would provide some basis from which customers could make comparisons between dealers. However, this approach would provide less precise insight into the transaction costs associated with specific transactions, might be misleading, and might cause investors to focus disproportionately on mark-ups to the detriment of an overall evaluation of the value of a specific transaction.

Finally, instead of requiring dealers to provide information about transaction costs, the MSRB could make modifications to EMMA that might provide greater insight into a dealer's transaction cost than currently possible from EMMA. For example, the MSRB could calculate, and report on EMMA, the difference between the prices of each reported trade and the trade in the same security that took place closest in time anywhere in the market. While such approaches would likely reduce or eliminate the burden on dealers, they would likely provide less insight into the transaction costs associated with specific transactions and specific dealers than under the mark-up disclosure proposal and could be misleading. Additionally, because such an approach would rely on customers to proactively seek out the information on EMMA, fewer customers may actually obtain the benefit of this approach.

4. Assessing the benefits and costs of the draft amendments to Rule G-15 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 baseline discussed above.

The MSRB has identified various data to help quantify the economic impact of the proposal. Trade data from EMMA provides an indication as to the portion of retail-size trades in municipal securities to which a potential disclosure requirement would apply. In addition, the MSRB has identified several studies that estimate the magnitude of transaction costs in the municipal securities market.⁴¹ The MSRB is seeking, as part of this request for comment, additional data or studies relevant to transaction costs, the costs of implementing the systems and processes necessary to comply with the draft amendments, and the potential unintended or indirect consequences of the draft amendments.

Benefits

The MSRB believes that the draft amendments would result in important benefits for a significant number of retail investors and promote a free and open municipal securities market.

Mark-up disclosure would provide investors with reliable insight into the transaction costs and dealer compensation associated with trading municipal securities and, thereby, foster more informed engagement between customers and dealers, as well as competition among dealers. Any resulting reduction in mark-ups would reduce costs paid by investors. The disclosure would also increase investor confidence that transaction costs are fair and reasonable.

Reducing transaction costs and increasing investor confidence may also encourage broader participation in the municipal securities market, improve liquidity, and lower borrowing costs for issuers. The draft amendments may also lower the cost of enforcement of existing regulations.

The MSRB also expects that the inclusion of a hyperlink and URL address to the Security Details page for the customer's security on EMMA would encourage greater use of EMMA and would provide customers with more information about the market for their security as of the time of their transaction.

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

⁴¹ See *supra* n. 39.

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 customer transactions that require mark-up disclosure, specify the mark-up, and provide additional information on customer confirmations.

The MSRB expects that the modifications needed to identify the transactions that require disclosure are likely to be the most costly aspect as dealers would need to determine if a customer's transaction meets a number of criteria. While some determinations (*e.g.*, whether a transaction is for an institutional account) may be relatively simple, others such as whether the dealer has transacted in the same security within a certain time period may require the development of a matching utility.⁴²

Because dealers are currently required under Rule G-30 to determine whether their mark-ups are fair and reasonable⁴³ and to determine the prevailing market price of a security as the basis for establishing a fair price in their transactions with customers,⁴⁴ the MSRB assumes that the determination of the mark-up will generally not impose significant costs for the universe of trades for which dealers would be required to provide disclosure under this proposal.⁴⁵ However, the MSRB recognizes that the transfer of this information to appropriate systems may involve costs.

The MSRB understands that changes to customer confirmations may be costly and has sought to limit this burden by limiting the amount of new

⁴² The MSRB notes that the costs associated with developing this type of matching utility may be avoided or significantly reduced if dealers were to voluntarily exceed the requirements of the draft amendments and provide mark-up disclosure for more, or even all, principal transactions.

⁴³ Rule G-30, supplementary material .01(a).

⁴⁴ See MSRB Reminds Firms of Their Sales Practice and Due Diligence Obligations When Selling Municipal Securities in the Secondary Market, MSRB Notice 2010-37 (Sept. 20, 2010).

⁴⁵ The MSRB previously published draft interpretive guidance on prevailing market prices and markups for transactions in municipal securities. See Request for Comments on Draft Interpretive Guidance on Prevailing Market Prices and Mark-up for Transactions in Municipal Securities, MSRB Notice 2010-10 (Apr. 21, 2010). However, this guidance was not adopted. As noted below, the MSRB seeks comment as to whether additional guidance is needed for establishing the prevailing market price in connection with the current mark-up disclosure proposal.

information that would need to be included. The MSRB also understands that changes to when and how confirmations are processed may have cost impacts and has sought to limit this burden by proposing to require firms to wait, at a maximum, two hours to determine whether disclosure will be required.

The MSRB assumes that the majority of the costs associated with these system changes would be one-time costs.

The MSRB is aware of the possibility that because the proposal only requires disclosure of a subset of transactions, dealers may reduce mark-ups on those trades that require disclosure but increase mark-ups on those trades that do not require disclosure.

The MSRB is aware that the inclusion of additional information on confirmations may prompt investors to engage more frequently with dealers, particularly given that investors will only receive disclosures on a subset of transactions. While these interactions have costs, the MSRB expects that the benefits of better-informed investors would be significant and would likely outweigh the costs.

The MSRB is also seeking comment on whether its mark-up disclosure proposal could have unintended impacts on market behavior including, but not limited to: firms holding fewer bonds in inventory, firms being incentivized to fill more orders out of inventory, and dealers promoting the greater use by customers of fee-based accounts.

Effect on Competition, Efficiency, and Capital Formation

The MSRB believes that the proposal would incentivize dealers to offer competitive prices in retail transactions to avoid losing transaction volume or putting client relationships at risk and, potentially, encourage clients to seek out other dealers that might offer more competitive mark-ups. Retail customers would have information that will allow them to make more informed choices, request additional information, and potentially evaluate the use of other dealers for future 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.

By encouraging dealers to seek ways to reduce transaction costs, the draft amendments may result in greater efficiency in the municipal securities market.

The MSRB also believes that lower transaction costs and increased investor confidence would encourage wider participation in the market and thus have a positive effect on capital formation.

In addition to the questions posed and matters discussed in this notice, the MSRB also requests comment, as a general matter, on any revised FINRA proposal as well as the below potential modifications to the MSRB's previously proposed pricing reference proposal.

Pricing Reference Information Disclosure Alternative

In Notice 2014-20, the MSRB sought comment as to the different elements of the pricing reference proposal, including: the retail-customer standard, exclusions from the disclosure requirement, disclosure format and reference transaction selection methodology in the event that more than one potential reference transaction was executed on the same day. The MSRB also sought comment as to explanatory notations that might be included on or with the confirmation.

Notice 2014-20 included an economic analysis of the pricing reference proposal. At this juncture, the MSRB believes that the below possible modifications to the pricing reference proposal may result in the proposal having the same or greater benefits than those that would result from the initial pricing reference proposal at a potentially lower cost. In response to comments received on the pricing reference proposal, the MSRB is now seeking comment on possible modifications to the proposal—including comments on the likely costs and benefits—in its ongoing consideration of the alternative.

Retail-Customer Standard

Under the pricing reference proposal, the MSRB has intended to require the pricing reference information disclosure only for retail customers, and the pricing reference proposal aimed to achieve this objective by requiring that the disclosures be provided only when the customer transaction involves 100 bonds or fewer or bonds in a par amount of \$100,000 or less. In response to Notice 2014-20, some commenters suggested that the use of a status-based standard, rather than a transaction-size standard would better align with the universe of "retail" customers on whom the pricing reference proposal should be focused. Commenters also suggested that dealers have already integrated into their processing systems a status-based retail / institutional account identification and that the use of this existing standard in connection with a pricing reference disclosure requirement would decrease the costs, but not the benefits, of the proposal. The MSRB now seeks comment as to whether it should require the disclosures only for accounts that are not

“institutional accounts” as defined in MSRB Rule G-8(a)(xi). This would be the same retail customer standard as that proposed under the mark-up disclosure proposal.

Exclusions

While the need for the initial pricing reference proposal focused on secondary market transactions, the MSRB did not initially propose an explicit exception for specific types of transactions. The MSRB now seeks comment as to whether it should limit the pricing reference disclosure proposal to the secondary market by providing that disclosure would be required only for a customer transaction that is not a “list offering price transaction” as described above in the MSRB’s mark-up disclosure proposal.

The MSRB also seeks comment as to whether it should exclude, as potential reference transactions, transactions between affiliated dealers upon the satisfaction of the same conditions set forth under the mark-up disclosure proposal. Specifically, if a dealer that transacts with customers acquires on an exclusive basis securities from, or sells on an exclusive basis securities to, an affiliated dealer that holds inventory in municipal securities and transacts with other market participants, the MSRB seeks comment as to whether the dealer that transacted with the customer should be required to “look through” its trades with its affiliated dealer and disclose as the reference transaction the external trade between its affiliated dealer and the third party with which its affiliated dealer transacted for the securities.

The MSRB also seeks comment as to whether a transaction should be excluded as a reference transaction if: (i) executed by a principal trading desk that is functionally separate from the principal trading desk that executed the customer transaction; and (ii) the functionally separate principal trading desk through which such transaction was executed had no knowledge of the retail customer transaction.⁴⁶ This would be consistent with the treatment of principal trading desks under the mark-up disclosure proposal.

⁴⁶ Note, however, that only purchases or sales that are required to be reported to RTRS (*i.e.*, purchase-sale transactions in which there is a transfer of ownership) could qualify as a reference transaction. Because an internal movement of securities between a dealer’s principal trading desks is not a reportable transaction under Rule G-14, such an internal movement would not qualify as a reference transaction. For example, if an “institutional” trading desk acquires 100 bonds in XYZ securities, and the “retail” trading desk within the same firm sells those bonds to a retail customer, the reference transaction would not be the internal movement between principal trading desks, rather it would be the “institutional” trading desk’s acquisition of those bonds (assuming the acquisition otherwise qualifies as a reference transaction).

Disclosure Format

The MSRB initially proposed to require dealers to disclose the differential between the customer transaction and the reference transaction expressed as a percentage of par. The MSRB now seeks comment as to whether, in addition to expressing this differential as a percentage, the differential should also be required to be disclosed as a total dollar amount.⁴⁷ These would be the same disclosure format requirements as proposed under the mark-up disclosure proposal.

Selection Methodology

The MSRB did not initially propose a specific methodology or methodologies to be used in determining which of potentially many reference transactions would be required to be disclosed on a customer confirmation. Rather, it sought comment as to the approach that should be used and sought comment on a number of methodologies set forth in FINRA's initial pricing reference proposal.⁴⁸ The MSRB again seeks comment on the appropriate standard(s) to be used in determining the reference transaction, and more specifically, seeks comment on the methodology proposed in FINRA's initial proposal and any revised FINRA proposal.

Cancels/Rebills

The MSRB seeks specific input on a possible clarification that dealers would not be required to resend confirmations due solely to a change in the reference transaction to be selected, the reference transaction price, or the differential between the customer price and reference transaction price. In addition, associated with this possible clarification, dealers would expressly be permitted to include a disclaimer on the customer confirmation that the reference price and related differential were determined as of the time of confirmation generation.

⁴⁷ 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 customer's transaction and the reference transaction. Multiplying the price differential by the par amount transacted would provide the total dollar amount difference between the customer's price and the reference transaction price. For example, a price differential of 2 expressed as a percentage of par means 2% of the par amount (*e.g.*, 2% of \$50,000 or $.02 \times \$50,000$). When expressed in dollars, this same differential would be \$1,000 ($2\% \times \$50,000$ par amount).

⁴⁸ See FINRA Regulatory Notice 14-52 (Nov. 2014).

Security-Specific Link to EMMA and Time of Execution

The MSRB seeks comment, in the context of the pricing reference proposal, whether dealers should be subject to the same requirements discussed above to provide a security-specific link to EMMA and include the time of execution for the customer's transaction.

Questions

Mark-up Disclosure Proposal

1. Would the proposed mark-up disclosure provide investors with greater transparency into the compensation of their dealers 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 mark-up disclosure proposal?
2. Do dealers have adequate regulatory guidance as to how they should determine their mark-ups or the prevailing market price for the class of principal transactions specified in the proposal, or for all principal transactions if any disclosure requirement were so expanded? If not, specifically what additional guidance would be helpful?
3. Is it appropriate to rebuttably presume that the prevailing market price for the customer's security, for purposes of calculating the mark-up or mark-down, would be established by referring to the dealer's contemporaneous cost or proceeds, and should such a presumption be adopted by rule? What is the appropriate strength of such a presumption? For situations in which the dealer, after receiving an order for a municipal security, executes a transaction to offset the customer's purchase or sale of the security, should the presumption be conclusive (*i.e.*, irrebuttable)?
4. How do dealers currently determine whether the mark-up being charged to customers transacting in municipal securities is fair and reasonable?
5. Is it more difficult, costly or burdensome for dealers to determine the prevailing market price and/or mark-up for those transactions for which they do not have a contemporaneously executed or nearly contemporaneously executed transaction in the same security?

6. What system changes would be required for dealers to comply with the requirements identified in the draft amendments? What are the costs associated with each of these changes?
7. Would the required disclosures encourage dealers to take actions to avoid making the proposed mark-up disclosures? For example, might dealers be incentivized to sell from inventory or hold securities until the relevant time period requiring disclosure has lapsed? If so, what effect might such actions have on the market? Would the risks or costs to dealers associated with holding securities in inventory significantly disincentivize such actions?
8. Since dealers already have processes and systems in place that are designed to ensure that their mark-ups on all principal transactions are fair and reasonable, should the MSRB take a different approach to determining which transactions require mark-up disclosure? For example, should the MSRB require disclosure on transactions for which a dealer had another transaction in the same security on the same day but more than two hours from the customer's transaction? Should the MSRB require disclosure on transactions for which a dealer executed another transaction(s) in the same security that did not equal or exceed the size of the customer's transaction? Should mark-up disclosure be required on all principal transactions?
9. Is there evidence of any error in the findings in the cited literature showing higher transaction costs in the municipal securities market compared to the corporate bond market and equities markets? Is there evidence of any error in the findings in the cited literature showing that retail investors pay more than institutional investors when trading municipal securities?
10. Is there evidence that the mark-ups associated with municipal securities transactions in which the dealer acts in a principal capacity are higher than they would be under conditions in which retail investors had access to more information about prices and/or dealer compensation or in which there was greater competition among dealers to serve retail investors?
11. Are there other relevant baselines the MSRB should consider when evaluating the economic impact of the mark-up disclosure proposal?

12. Are there data or studies relevant to the evaluation of the benefits and costs of the mark-up disclosure proposal that the MSRB should consider?
13. Are there data to support or call into question the MSRB's estimate, based on trade size, that at least half of retail trades in the secondary market would result in disclosure?
14. How are retail investors likely to use information about mark-ups?
15. What is the range of potential transaction cost reductions that could be expected after full implementation of the mark-up disclosure proposal?

Mark-up Disclosure Proposal and Potential Modifications to the Pricing Reference Proposal

16. Is the MSRB's proposed retail-customer standard, in connection with its mark-up disclosure proposal and the potential modifications to its pricing reference proposal, the standard that should be applied in light of the objectives of the proposals? If not, what should the standard be? Should the mark-up disclosures be limited to retail customers at all or should it be extended to all customers, retail and institutional?
17. Is the MSRB's proposed standard for excluding the primary market in connection with its mark-up disclosure proposal and the potential modifications to its pricing reference proposal the appropriate standard to apply? Are there alternative approaches that would better exclude primary market trades while still focusing the benefit of the proposed disclosures on retail investors in the secondary market?
18. What would be the cost to dealers, above and beyond the other costs associated with the mark-up disclosure proposal and the potential modifications to the pricing reference proposal, of the MSRB's proposed "look through?"
19. Should the proposed provision of a link (and URL address) to the EMMA Security Details page for a customer's security be required, as is proposed, on all retail customer confirmations, or just those for which mark-up disclosures or pricing reference disclosures would be required?

20. What changes should the MSRB consider making to EMMA to provide investors with additional insight into transaction costs?

Potential Modifications to the Pricing Reference Proposal

21. Should the MSRB require that a single reference transaction selection methodology be used under all scenarios? For example, in the case of a customer purchase, should the reference transaction be the dealer's last same-day purchase, if any, of the securities that the customer traded that preceded the customer trade; and in the case of a customer sale, should the reference transaction be the dealer's first sale of the same securities following the customer sale if the dealer makes any sale by the end of the same trading day?
22. For purposes of establishing a reference price, should the dealer be required to consider its principal trades with dealers and customers, or only its principal trades with dealers?

September 24, 2015

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Text of Draft Amendments*

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) Transaction information. The confirmation shall include information regarding the terms of the transaction as set forth in this subparagraph (A):

(1) No change.

(2) Trade date and time of execution. The trade date and time of execution, accurate to the nearest minute, shall be shown. ~~In addition, either (a) the time of execution, or (b) a~~

* Underlining indicates new language; strikethrough denotes deletions.

~~statement that the time of execution will be furnished upon written request of the customer shall be shown.~~

(3) – (8) No change.

(B) – (C) No change.

(D) Disclosure statements:

(1) - (3) No change.

(4) The confirmation for a transaction executed for an account other than an institutional account (as defined in MSRB Rule G-8(a)(xi)) shall include a hyperlink and uniform resource locator address to the Security Details page for the customer’s security on EMMA, along with a brief description of the type of information available on that page.

(E) Confirmation format. All requirements must be clearly and specifically indicated on the front of the confirmation, except that the following statements may be on the reverse side of the confirmation:

(1) – (2) No change.

~~(3) The statement concerning time of execution that can be provided in satisfaction of subparagraph (A)(2) of this paragraph.~~

(F) Mark-ups and Mark-downs.

(1) General. If the broker, dealer or municipal securities dealer (“dealer”) is effecting a transaction in a principal capacity for an account that is not an institutional account (as defined in Rule G-8(a)(xi)), the confirmation shall include the dealer’s mark-up or mark-down from the prevailing market price for the security, expressed as a total dollar amount and as a percentage of the principal amount of the transaction, if:

(a) In the case of a sale to a customer, the dealer (or affiliate of the dealer, in the case of an inventory-affiliate model) purchased the security in one or more transactions in an aggregate trade size meeting or exceeding the size of such sale within two hours of the customer transaction; or

(b) In the case of a purchase from a customer, the dealer (or affiliate of the dealer, in the case of an inventory-affiliate model) sold the security in one or more transactions in an aggregate trade size meeting or exceeding the size of such purchase within two hours of the customer transaction.

(2) Notwithstanding subparagraph (F)(1) above, a dealer shall not be required to disclose the mark-up if: (a) the customer transaction was executed by a principal trading desk that is functionally separate from the principal trading desk within the same dealer that executed the dealer purchase (in the case of a sale to a customer) or dealer sale (in the case of a purchase from a customer) of the security; and (b) the functionally separate principal trading desk through which the dealer purchase or dealer sale was executed had no knowledge of the customer transaction.

(3) The term “inventory-affiliate model” shall mean a business model in which the dealer, on an exclusive basis, acquires municipal securities from or sells municipal securities to an affiliated dealer that holds inventory in municipal securities and transacts with other market participants.

(4) This paragraph (F) shall not apply to a customer transaction that is a “list offering price transaction” as defined in paragraph (d)(vii) of Rule G-14 RTRS Procedures.

(5) This paragraph (F) shall not apply to transactions in municipal fund securities.

(ii) – (viii) No change.

(b) – (g) No change.