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Request for Comment

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March 31, 2016

Category

Uniform Practice

Affected Rules

[Rule G-30](#)

Request for Comment on Draft Amendments to MSRB Rule G-30 to Provide Guidance on Prevailing Market Price

Overview

The Municipal Securities Rulemaking Board (MSRB) is seeking comment on draft amendments to MSRB Rule G-30, on prices and commissions, to provide guidance on establishing the prevailing market price and calculating mark-ups and mark-downs for principal transactions in municipal securities (the “Draft Guidance”). The MSRB believes additional guidance on these subjects may promote consistent compliance by brokers, dealers and municipal securities dealers (collectively, “dealers”) with their existing fair-pricing obligations under MSRB rules, in a manner that would be generally harmonized with the approach taken in other fixed income markets. The MSRB also believes additional guidance could be necessary for the effective implementation of a potential future mark-up disclosure requirement.

Comments should be submitted no later than March 31, 2016, 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, 1300 I Street NW, Suite 1000, Washington, DC 20005. Generally, all comments will be made available for public inspection on the MSRB’s website.¹

Questions about this notice should be directed to Michael L. Post, General Counsel – Regulatory Affairs, Margaret Blake, Associate General Counsel, or Saliha Olgun, Assistant General Counsel, at 202-838-1500.

¹ Comments generally are posted on the MSRB website without change. For example, 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.



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Background

The MSRB is charged by Congress to promote a fair and efficient municipal securities market and to protect investors and the public interest.² Under this mandate, the MSRB has developed and adopted a detailed set of regulatory requirements regarding dealer pricing and compensation. Rule G-30 generally 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 or mark-down (collectively, “mark-up”)) that is fair and reasonable.³ The “prevailing market price” of a municipal security is a central concept in Rule G-30. Under Rule G-30, the total transaction price to the customer must bear a reasonable relationship to the prevailing market price of the security,⁴ and, in a principal transaction, the dealer’s compensation (*i.e.*, the mark-up) must be computed from the inter-dealer market price prevailing at the time of the customer transaction.⁵ Moreover, Rule G-30 obligates dealers to exercise reasonable diligence in establishing the market value of the security and the reasonableness of their compensation.⁶ Thus, the MSRB has previously cautioned that it is possible for a dealer to charge reasonable compensation and still violate Rule G-30 because of insufficient attention to market value.⁷

MSRB Rule G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers, in relevant part, requires dealers to disclose on the customer confirmation remuneration to be received from a customer when the dealer acts as agent (*i.e.*, the commission). However, there is currently no comparable requirement with respect to disclosure of the mark-up when the dealer acts as principal.

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

³ MSRB Rule G-30(a).

⁴ Rule G-30(a); Rule G-30, Supplementary Material .01(c).

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

⁶ Rule G-30, Supplementary Material .01(a); Rule G-30, Supplementary Material .04(b) (“[D]ealers must establish market value as accurately as possible using reasonable diligence under the facts and circumstances.”). The draft amendments include a clarification of this reasonable diligence standard in Supplementary Material .01(a).

⁷ Review of Dealer Pricing Responsibilities - January 26, 2004 (archived and available at www.msrb.org).

In September 2015, the MSRB published MSRB Notice 2015-19 seeking comment on draft rule amendments to require dealers to disclose the mark-up on retail customer confirmations for specified principal transactions (the “mark-up disclosure proposal”). Under the proposal, dealers generally would be required to disclose the mark-up on retail customer confirmations when they transact on the same side of the market 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.⁸ The mark-up to be disclosed, consistent with Rule G-30, would be computed from the prevailing market price for the security at the time of the customer transaction. The MSRB specifically sought comment as to whether dealers could benefit from additional regulatory guidance on the establishment of prevailing market price and the calculation of mark-ups for the class of principal transactions specified in the proposal, or for all principal transactions with customers. In a coordinated effort, the Financial Industry Regulatory Authority (FINRA) also published a related, but not identical, confirmation disclosure proposal for other fixed income securities markets, which also requested comment on the MSRB’s mark-up disclosure proposal.⁹

In response to the mark-up disclosure proposal, commenters strongly urged a coordinated and consistent approach to confirmation disclosure by the MSRB and FINRA for the fixed income securities markets. A number of commenters also indicated that additional guidance on prevailing market price would be beneficial to support effective compliance with a possible future mark-up disclosure requirement. Some commenters noted that while dealers may currently have in place processes and systems that are designed to ensure that their mark-up on a principal transaction is fair and reasonable and that the total transaction price to a customer bears a reasonable relationship to the prevailing market price of the security, the specificity with which dealers would need to ascertain the prevailing market price of a security under the mark-up disclosure proposal would require additional guidance.

These recent suggestions of additional guidance are consistent with a recommendation in the Securities and Exchange Commission’s (SEC) Report

⁸ Under the proposal, dealers also would be required to include on all retail customer confirmations a CUSIP-specific link to the MSRB’s Electronic Municipal Market Access (EMMA[®]) website.

⁹ See FINRA Regulatory Notice 15-36 (Oct. 2015).

on the Municipal Securities Market.¹⁰ The SEC Report recommended that the MSRB consider providing more detailed guidance on how dealers should establish the prevailing market price for municipal securities and recommended consistency with guidance issued by FINRA for non-municipal fixed income securities.¹¹

FINRA Guidance

For principal transactions in non-municipal fixed income securities, the prevailing market price and mark-up generally must be determined in accordance with FINRA Rule 2121, including Supplementary Material .01, Mark-Up Policy, and Supplementary Material .02, Additional Mark-Up Policy for Transactions in Debt Securities, Except Municipal Securities. Supplementary Material .02 was approved by the SEC and became effective in 2007 (the “FINRA Guidance”).¹² Under the FINRA Guidance, the prevailing market price of a security generally is presumptively established by referring to the dealer’s contemporaneous cost as incurred, or contemporaneous proceeds as obtained. This presumption may be overcome in limited circumstances. If the presumption is overcome, or if it is not applicable because the dealer’s cost is (or proceeds are) not contemporaneous, various factors are either required or permitted to be considered, in successive order, to determine the prevailing market price. Generally, a subsequent factor or series of factors may be considered only if previous factors in the hierarchy, or “waterfall,” are inapplicable.

Summary of Draft Prevailing Market Price Guidance

The Draft Guidance, which would be codified in a new paragraph .06 of the Supplementary Material to Rule G-30, is designed to harmonize the manner in which the “prevailing market price” for municipal securities is determined with the manner established by FINRA for purposes of other types of fixed income securities, to the extent appropriate in light of the differences between the markets. As discussed in detail below, like many commenters on the mark-up disclosure proposal, the MSRB believes that consistency and harmonization of regulatory standards regarding the same subject matter and affecting, in many instances, the same regulated persons would increase efficiencies in regulation and reduce dealer implementation and compliance

¹⁰ See U.S. Securities and Exchange Commission, Report on the Municipal Securities Market (July 31, 2012) (“SEC Report”).

¹¹ See *id.* at 148. The MSRB previously sought public comment on draft interpretive guidance on these subjects in 2010. See MSRB Notice 2010-10 (April 21, 2010).

¹² The descriptions in this notice of the FINRA Guidance are based on the MSRB’s understanding of that guidance.

costs. The MSRB believes that this is particularly the case with respect to a possible future mark-up disclosure requirement. The MSRB's consideration of harmonized guidance regarding prevailing market price is also consistent with the SEC's recommendation in the SEC Report.

At the same time, the MSRB is conscious of the unique characteristics of the municipal securities market, including the large number of issuers and outstanding securities, the infrequent trading of many securities in the secondary market, differing tax rules and treatment, and different credit structures, enhancements and redemption features that may not be applicable to or prevalent for other fixed income securities. Accordingly, the Board is concerned that a wholesale application of the FINRA Guidance to the municipal securities market, absent modifications or additional explanatory material to take into account the differences between the markets, in some cases, would result in inaccurate assessments of the prevailing market price and, consequently, inaccurate calculations of mark-ups.

With these issues in mind, the Draft Guidance on which the MSRB seeks comment was developed to be substantially similar to the FINRA Guidance, with modifications intended to tailor it to the characteristics of the municipal securities market. To help ensure appropriate tailoring, the MSRB seeks comment as to the appropriateness of this generally harmonized approach and, particularly, whether the modifications are appropriate and whether additional modifications should be made.

Rebuttable Presumption Based on Contemporaneous Cost or Proceeds.

Under the FINRA Guidance, the prevailing market price of a non-municipal fixed income security is presumptively established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with FINRA pricing rules, such as the best-execution rule (FINRA Rule 5310). A transaction is contemporaneous under the FINRA Guidance if it occurs close enough in time that it would reasonably be expected to reflect the current market price for the subject security. A dealer may be able to show that its contemporaneous cost (when it is making a sale to a customer) or proceeds (when it is making a purchase from a customer) are not indicative of the prevailing market price, and thus overcome the presumption, in instances where: (i) interest rates changed after the dealer's contemporaneous transaction to a degree that such change would reasonably cause a change in debt securities pricing; (ii) the credit quality of the debt security changed significantly after the dealer's contemporaneous transaction; or (iii) news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security after the dealer's contemporaneous transaction. The Draft Guidance

follows these same policies for transactions in municipal securities, but, instead of referring to consistency with FINRA rules, refers to consistency with applicable MSRB rules, such as MSRB Rule G-18, on best-execution.

The MSRB invites comment as to whether there may be additional instances in the municipal market in which a dealer may be able to show that its contemporaneous cost or proceeds are not indicative of the prevailing market price. For example, should a dealer be able to overcome the presumption when there are intervening changes in yields against a widely used benchmark to such a degree that it would reasonably cause a change in municipal securities pricing? If so, are there any situations involving such changes in yield that would not already be adequately identified as associated with changes in interest rates or the issuance or distribution of news? Should trade size be included as a relevant consideration in either identifying a contemporaneous transaction or overcoming the above presumption, or do market participants believe that a contemporaneous transaction, regardless of trade size, is the most relevant and probative evidence of the prevailing market price for the security?

Hierarchy of Pricing Factors. Under the FINRA Guidance, if the dealer has established that the dealer's cost is (or proceeds are) not contemporaneous or if the dealer has overcome the presumption that its contemporaneous cost or amount of proceeds provides the best measure of the prevailing market price, the dealer must consider, in the order listed, a hierarchy of three additional types of pricing information: (i) prices of any contemporaneous inter-dealer transactions in the security; (ii) prices of contemporaneous dealer purchases (or sales) in the security from (or to) institutional accounts with which any dealer regularly effects transactions in the same security; or (iii) if an actively traded security, contemporaneous bid (or offer) quotations for the security made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations. Pricing information of a succeeding type may only be considered where the prior type does not generate relevant pricing information. In reviewing the available pricing information of each type, the relative weight of the information depends on the facts and circumstances of the comparison transaction or quotation. The Draft Guidance follows all of these same policies,¹³ but includes explanatory material that makes explicit the

¹³ These FINRA policies and those discussed regarding similar securities are generally consistent with, though more detailed than, those currently embodied in Rule G-30. For example, under Rule G-30, dealer compensation with respect to a principal transaction "is computed from the inter-dealer market price prevailing at the time of the customer transaction." Rule G-30, Supplementary Material .01(d). Also under Rule G-30, a dealer "may

expectation that these factors may frequently not be available for municipal securities. This explanatory material and the tailored treatment of isolated transactions and quotations under the Draft Guidance (discussed below) recognize that dealers may often need to consult factors further down the waterfall, such as “similar” securities and economic models, to identify sufficient relevant and probative pricing information to establish the prevailing market price of a municipal security.

The MSRB seeks comment as to all aspects of the hierarchy of pricing factors. Is the hierarchical approach an appropriate one for the municipal securities market? Are there any other factors that should be expressly included at this point in the process for establishing the prevailing market price? Is the requirement that the municipal security be actively traded in order for the dealer to consider quotations for the security an appropriate requirement, or should quotations be permitted to be considered for inactively traded securities?

Similar Securities. Under the FINRA Guidance, if the above factors are not available, other factors may be taken into consideration in establishing the prevailing market price. The FINRA Guidance sets forth a non-exclusive list of factors that are generally analogous to those set forth under the hierarchy of pricing factors described above, but applied here to prices and yields of specifically defined “similar” securities. These factors related to similar securities, however, are not required to be considered in a particular order or particular combination. The relevant weight of the pricing information obtained from these factors depends on the facts and circumstances surrounding the comparison transaction, such as whether the dealer in the comparison transaction was on the same side of the market as the dealer in the subject transaction and the timeliness of the information.

Under the FINRA Guidance, a “similar” security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the “similar” security or securities. Where a security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security. The FINRA Guidance also sets forth a number of factors that may be used in determining the degree to which a security is “similar,” including: (i) credit quality considerations; (ii) the extent to which the spread at which the

need to review recent transaction prices for the issue or transaction prices for issues with similar credit quality and features as part of its duty to use diligence to determine the market value of municipal securities.” Rule G-30, Supplementary Material .04(b)(i).

“similar” security trades is comparable to the spread at which the subject security trades; (iii) general structural characteristics and provisions of the issue; and (iv) technical factors.

Also under the FINRA Guidance, when a security’s value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security (often referred to as “story bonds”), in most cases other securities will not be sufficiently similar, and therefore, other securities may not be used to establish the prevailing market price.

The Draft Guidance follows all of these same policies, but includes an additional factor that may be used in determining the degree to which a security is “similar.” The additional factor is the extent to which the federal and/or state tax treatment of a potentially “similar” municipal security is comparable to the tax treatment of the subject security. The MSRB seeks comment as to whether there should be different or additional factors that may be taken into consideration in identifying the degree to which a security is “similar” under the Draft Guidance. Do commenters believe that any additional guidance is warranted for “similar” municipal securities in light of the facts that there are many more municipal security issuers than, for example, corporate bond issuers, many more municipal CUSIP numbers than corporate CUSIP numbers, and secondary market trading in many municipal securities is not as active as it is for many other fixed income securities?

Isolated Transactions and Quotations. Under the FINRA Guidance, because the ultimate issue that the guidance is intended to address is the prevailing market price of the security, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing the prevailing market price. The Draft Guidance follows the same policy and adds explanatory material to the statement of this policy in light of the fact that isolated transactions and isolated quotations may be more prevalent in the municipal securities market than other fixed income markets. This material explains that, for example, in considering the factors in the hierarchy of pricing factors, a dealer may give due regard to whether the relevant pricing information is being derived from an isolated transaction or quotation.

The MSRB invites comment in particular as to whether this treatment of isolated transactions and quotations is appropriate given that, in the municipal securities market, the existence of only isolated transactions or quotations may be a more frequent occurrence than in other fixed income securities markets. Do commenters believe that additional guidance is necessary with respect to the treatment of isolated transactions or

quotations under specific circumstances likely to arise in the municipal securities market? If so, please describe such circumstances. Or do commenters agree that, if using guidance substantially the same as the FINRA Guidance, it would simply be the case that consideration of factors further down the waterfall will be more likely, as a matter of application of the guidance, in the municipal securities market? Do commenters believe that the proposed expanded explanatory material regarding the weight and relevance of isolated transactions and quotations provides dealers with an appropriate degree of flexibility to take into consideration factors at lower levels in the waterfall in the event that the only transactions or quotations for the subject security are isolated ones?

Economic Models. Under the FINRA Guidance, if information concerning the prevailing market price of a security cannot be obtained by applying any of the factors at the higher levels of the waterfall, dealers may consider as a factor in assessing the prevailing market price of a security the prices or yields derived from economic models. Such economic models may take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value, and may consider all applicable pricing terms and conventions used. The Draft Guidance follows this same policy.

The MSRB invites comment as to whether dealers currently utilize economic models within their firms to establish the prevailing market price of municipal securities, and if so, to what degree. If used, are such models typically considered earlier in the analytical process or, consistent with the Draft Guidance, are they considered only after consulting relevant trade prices and quotations? Do commenters agree with the measures set forth in the Draft Guidance of which economic models may take account in determining prevailing market price, or should other or fewer measures apply in the municipal securities market?

Figure 1 below provides an overview of the Draft Guidance.

Overview of Draft Guidance

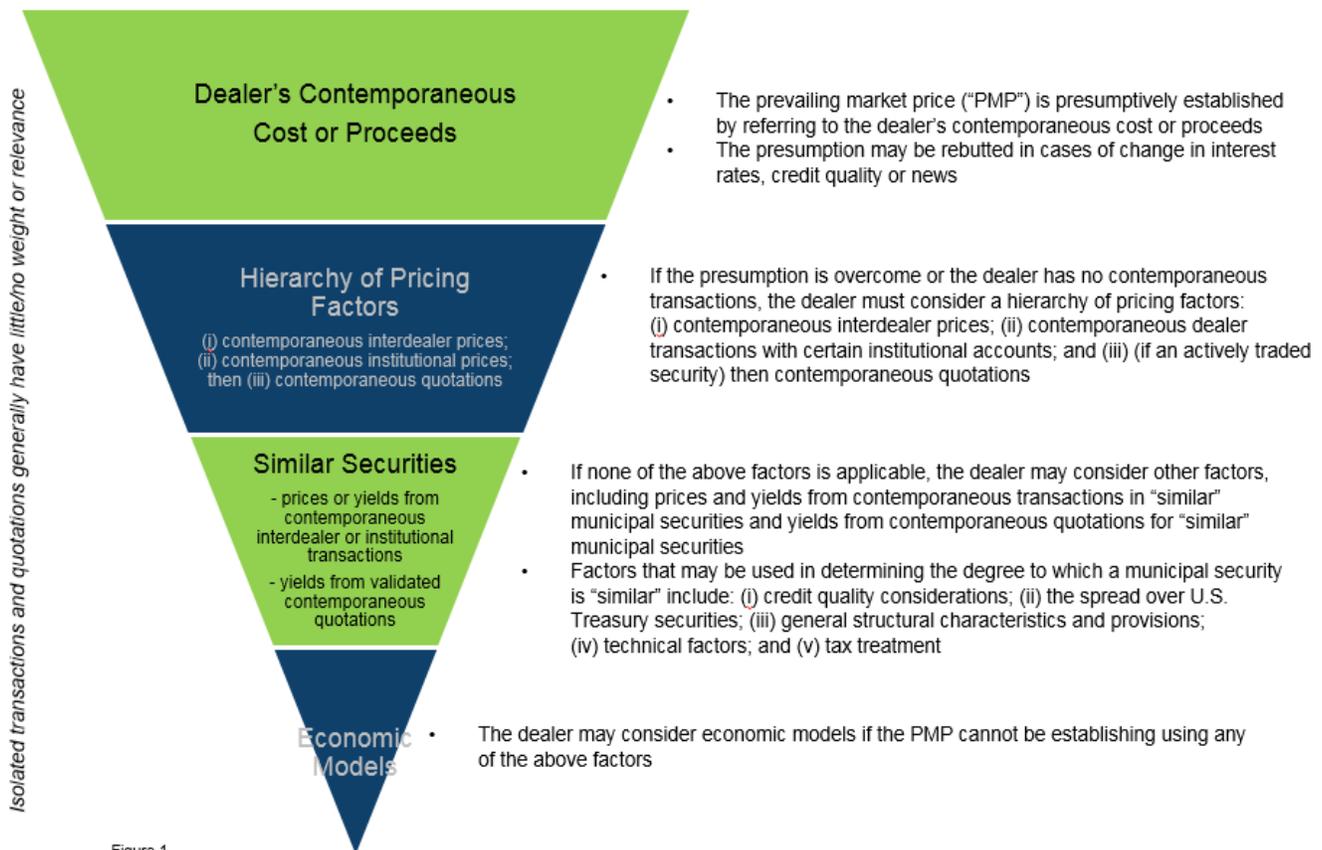


Figure 1

Economic Analysis

1. The need for the Draft Guidance.

As noted above, the need for the Draft Guidance arises primarily from the comments received in response to the MSRB's mark-up disclosure proposal. A number of commenters stated that at least some additional guidance would be necessary in order for dealers to comply with the proposal. In the absence of additional guidance, dealers may find it difficult to confidently calculate the prevailing market price of a municipal security with the specificity required by the MSRB's mark-up disclosure proposal. Commenters also strongly urged a coordinated and consistent approach to confirmation disclosure between the MSRB and FINRA, expressing support for providing disclosures in a manner that is consistent across fixed income markets. Specific guidance currently exists to assist dealers in determining the

prevailing market price of their non-municipal fixed income securities, while such specific guidance does not currently exist for municipal securities. To the extent that FINRA and the MSRB both proceed with a confirmation disclosure initiative that uses the prevailing market price of a security as a point of reference, this inconsistency in guidance could harm investors and could create a burden on dealers by potentially implying significantly different implementation approaches in response to any future MSRB or FINRA rules related to confirmation disclosure. The SEC Report recommended the MSRB consider providing additional prevailing market price guidance, independent of consideration of any mark-up disclosure initiative.¹⁴

In addition, because mark-ups on principal transactions have been the focus of significant attention,¹⁵ additional guidance on the manner in which prevailing market prices for municipal securities should be determined may support dealer efforts to ensure they are in compliance with their existing obligations under Rule G-30 and make the enforcement of Rule G-30 more efficient.

The Draft Guidance would address these needs by providing a set of principles upon which dealers may rely under a wide range of market conditions. Because these principles are substantially similar to those already promulgated by FINRA, the Draft Guidance would support the goal of consistency across fixed income markets.

2. Relevant baselines against which the likely economic impact of elements of the Draft Guidance should be considered.

The relevant baseline against which the likely economic impact of the Draft Guidance should be considered is existing Rule G-30 that obligates dealers to “exercise diligence in establishing the market value [of a security] . . . and the reasonableness of the compensation” when effecting a trade on a principal

¹⁴ SEC Report at 148.

¹⁵ See, e.g., *id.* at 115-116, 123-126; 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>, and 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>.

basis.¹⁶ Rule G-30 also clearly establishes that the “prevailing market price” is the basis for evaluating whether prices are “fair and reasonable”¹⁷ and for determining the amount of the dealer’s mark-up or mark-down.¹⁸ The baseline against which the likely economic impact of the Draft Guidance should be considered thus assumes that dealers currently have in place policies, procedures and systems necessary to exercise diligence in determining the prevailing market price of a security and assure that their mark-ups charged are reasonable when effecting a transaction.

In addition, for those dealers that transact in both municipal securities and corporate or agency debt securities, the FINRA Guidance may represent a baseline to the extent dealers are utilizing this guidance to determine the prevailing market price of municipal securities.

3. Identifying and evaluating reasonable alternative regulatory approaches.

The MSRB recognizes that there are alternatives to the approach taken in the Draft Guidance.

The MSRB could continue to rely on the existing guidance included in Rule G-30. While this approach would not place any additional burdens on dealers to modify existing policies, procedures or systems, it may make compliance with any potential MSRB mark-up disclosure requirement more burdensome or costly and would likely result in less consistent approaches to mark-up disclosure across fixed income markets which could increase confusion among market participants.

Alternatively, the MSRB could adopt guidance for determining the prevailing market price of municipal securities that diverges substantially from the FINRA Guidance. For example, the MSRB could adopt guidance that offers dealers significantly greater flexibility in determining which factors should be used. While the MSRB recognizes that such an approach could, under some circumstances, reduce compliance costs, the MSRB believes, at this stage in the rulemaking process, that the benefits of harmonization to the greatest extent possible likely provide benefits to dealers and investors that significantly outweigh the benefits of divergence.

¹⁶ Rule G-30, Supplementary Material .01(a).

¹⁷ Rule G-30, Supplementary Material .01(c).

¹⁸ Rule G-30, Supplementary Material .01(d).

Finally, the MSRB could adopt the FINRA Guidance without any modifications intended to accommodate ways in which the municipal securities market may differ from other fixed income markets. Particularly for dealers already complying with the FINRA Guidance, this alternative may represent a lower burden than the Draft Guidance. Nonetheless, the MSRB believes promulgating guidance that is identical to the FINRA Guidance and lacking any additional tailored explanatory material could, at times, result in inaccurate assessments of prevailing market prices and, consequently, inaccurate calculations of mark-ups.

4. Assessing the benefits and costs of the Draft Guidance.

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 is seeking, as part of this request for comment, data or studies relevant to the determination of prevailing market price, the costs of implementing the systems and processes necessary to comply with the Draft Guidance, and the potential unintended or indirect economic consequences of the Draft Guidance. Preliminarily, the MSRB has evaluated the benefits and costs associated with the proposed amendments as follows:

Benefits

The MSRB believes that the Draft Guidance reflects an appropriate balance between consistency with existing FINRA Guidance for determining prevailing market price in other fixed income securities markets and modifications to address circumstances under which use of the FINRA Guidance in the municipal securities market might be inappropriate.

Consistency and harmonization between regulatory standards regarding the same subject matter and affecting, in many instances, the same regulated persons may reduce the burdens, costs, and time associated with dealer implementation and compliance and make enforcement more efficient. The MSRB also believes that harmonization could ultimately result in more consistent disclosures and expectations for retail investors across their fixed income security holdings. Harmonized prevailing market price and mark-up guidance between the MSRB and FINRA could also provide dealers with greater certainty in their current fair-pricing compliance processes and any potential future confirmation disclosure processes. In addition, harmonized guidance could provide investors with clearer expectations with regard to dealer obligations across markets. To the extent guidance is harmonized, dealers that effect transactions in other fixed income securities may also be

able to leverage existing processes developed to comply with FINRA Rule 2121 to comply with their Rule G-30 obligations.

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 amendments to isolate the costs attributable to the incremental requirements of the Draft Guidance.

The MSRB believes that the Draft Guidance would likely require dealers to modify their existing policies, procedures, and systems currently used to ensure compliance with Rule G-30. These changes may, in turn, affect other aspects of a dealer's daily operations which could result in higher costs, particularly for those securities for which the determination of a prevailing market price cannot be automated.

The MSRB is not aware of any available data that would support a quantitative estimate of the overall impact of the Draft Guidance. The MSRB specifically seeks comments that would inform a quantitative estimate of the benefits and costs associated with the Draft Guidance.

Effect on Competition, Efficiency, and Capital Formation

The MSRB believes that the Draft Guidance may improve capital formation, competition, and efficiency to the extent it results in more competitive pricing and increased investor confidence in the municipal securities market. The MSRB acknowledges, however, that under some circumstances more detailed guidance may reduce efficiency. The MSRB recognizes that larger dealers, and particularly those with significant experience with the FINRA Guidance, may be able to implement the Draft Guidance at a lower cost than smaller firms and/or firms that only transact in municipal securities. On the other hand, firms that hold inventories for relatively short periods of time and, therefore, may be able to more frequently rely on contemporaneous cost or proceeds to determine prevailing market price, may find the ongoing cost of complying with the Draft Guidance to be relatively limited.

Request for Comment

In addition to the questions asked elsewhere in this request for comment, the MSRB seeks public comment on the following questions, as well as any other comments on the subjects of prevailing market price and mark-up calculation. The MSRB welcomes information regarding the potential to quantify the likely benefits and costs of the Draft Guidance. The MSRB also

requests comment on any competitive or anticompetitive effects, as well as efficiency and capital formation effects of the Draft Guidance on any market participants. 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. Do the principles laid out in the Draft Guidance represent the appropriate approach to establishing prevailing market price in the context of the municipal securities market?
2. Does the Draft Guidance provide dealers with additional helpful guidance for purposes of complying with their fair-pricing obligations under Rule G-30?
3. Would the Draft Guidance provide dealers with sufficient guidance to calculate their mark-ups for purposes of complying with a potential mark-up disclosure requirement where dealers had a corresponding trade(s) within two hours, on the same trading day, or regardless of whether dealers had a corresponding trade(s)?
4. Are there other viable alternatives to the Draft Guidance not identified in this request for comment?
5. Would the Draft Guidance impose any burden on competition that is not necessary or appropriate?
6. To what extent are dealers currently utilizing the FINRA Guidance or a similar approach to establish the prevailing market price of municipal securities?
7. Has the MSRB correctly described the baseline against which the costs and benefits of the Draft Guidance should be measured?
8. How should the MSRB evaluate the potential benefits of consistency with the FINRA Guidance?
9. Would the Draft Guidance impose any cost or burdens, direct, indirect, or inadvertent, on investors or regulated entities other than those identified in this request for comment?
10. Please provide data or other evidence including studies or research that support commenters' estimates of benefits and costs that would be associated with the Draft Guidance and any potential reasonable alternatives.

11. What system changes would be required to comply with the Draft Guidance and what are the estimated costs associated with those changes?

February 18, 2016

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Text of Draft Amendments*

Rule G-30: Prices and Commissions

(a) *Principal Transactions.*

No broker, dealer or municipal securities dealer shall purchase municipal securities for its own account from a customer, or sell municipal securities for its own account to a customer, except at an aggregate price (including any mark-up or mark-down) that is fair and reasonable.

(b) *Agency Transactions.*

(i) Each broker, dealer and municipal securities dealer, when executing a transaction in municipal securities for or on behalf of a customer as agent, shall make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions.

(ii) No broker, dealer or municipal securities dealer shall purchase or sell municipal securities as agent for a customer for a commission or service charge in excess of a fair and reasonable amount.

Supplementary Material

.01 General Principles.

(a) Each broker, dealer or municipal securities dealer (each, a “dealer,” and collectively, “dealers”), whether effecting a trade on an agency or principal basis, must exercise reasonable diligence in establishing the market value of the security and the reasonableness of the compensation received on the transaction.

(b) – (c) No change.

* Underlining indicates new language; strikethrough denotes deletions.

(d) Dealer compensation on a principal transaction with a customer is considered to be a mark-up or mark-down that is computed from the ~~inter-dealer market price~~ prevailing market price at the time of the customer transaction. As part of the aggregate price to the customer, the mark-up or mark-down also must be a fair and reasonable amount, taking into account all relevant factors.

(e) No change.

.02 - .05 No change.

.06 Mark-Up Policy

(a) Prevailing Market Price

(i) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. Presumptively for purposes of this Supplementary Material .06, the prevailing market price for a municipal security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with applicable MSRB rules. (See, e.g., Rule G-18).

(ii) When the dealer is *selling* the municipal security to a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no *contemporaneous purchases* in the security or can show that in the particular circumstances the *dealer's contemporaneous cost* is not indicative of the prevailing market price. When the dealer is *buying* the municipal security from a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no *contemporaneous sales* in the security or can show that in the particular circumstances the *dealer's contemporaneous proceeds* are not indicative of the prevailing market price.

(iii) A dealer's cost is (or proceeds are) considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the municipal security.

(iv) A dealer that effects a transaction in municipal securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost (or, in a mark-down, the dealer's own proceeds) must be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or, the dealer's proceeds) provides the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost is (or proceeds are) not indicative of prevailing market price, and thus overcome the presumption, in instances where: (A) interest rates changed after the dealer's contemporaneous transaction to a degree that such change would reasonably cause a change in municipal securities pricing; (B) the credit quality of the municipal security changed significantly after the dealer's contemporaneous transaction; or (C)

news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the municipal security after the dealer's contemporaneous transaction.

(v) In instances where the dealer has established that the dealer's cost is (or, in a mark-down, proceeds are) not contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or proceeds) provides the best measure of the prevailing market price, such as those instances described in (a)(iv)(A), (B) and (C), the dealer must consider, in the order listed and subject to (b)(viii), the following types of pricing information to determine prevailing market price:

(1) Prices of any contemporaneous inter-dealer transactions in the municipal security in question;

(2) In the absence of transactions described in (1), prices of contemporaneous dealer purchases (sales) in the municipal security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same municipal security; or

(3) In the absence of transactions described in (1) and (2), for actively traded municipal securities, contemporaneous bid (offer) quotations for the security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations.

In reviewing the pricing information available within each category, the relative weight, for purposes of identifying prevailing market price, of such information (i.e., a particular transaction price or quotation) depends on the facts and circumstances of the comparison transaction or quotation (e.g., whether the dealer in the comparison transaction was on the same side of the market as the dealer in the subject transaction and timeliness of the information).

Because of the lack of active trading in most municipal securities, it is not always possible to establish the prevailing market price for a municipal security based solely on contemporaneous transaction prices or contemporaneous quotations for the security. Accordingly, dealers may often need to consider other factors, consistent with (b)(vi) and (b)(vii) below.

(vi) In the event that, in particular circumstances, the above factors are not available, other factors that may be taken into consideration (not in any required order or combination) for the purpose of establishing the price from which a customer mark-up (mark-down) may be calculated, include but are not limited to:

- Prices, or yields calculated from prices, of contemporaneous inter-dealer transactions in a "similar" municipal security, as defined below;

- Prices, or yields calculated from prices, of contemporaneous dealer purchase (sale) transactions in a "similar" municipal security with institutional accounts with which

any dealer regularly effects transactions in the “similar” municipal security with respect to customer mark-ups (mark-downs); and

- Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in “similar” municipal securities for customer mark-ups (mark-downs).

The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the factors set forth above depends on the facts and circumstances surrounding the comparison transaction (i.e., whether the dealer in the comparison transaction was on the same side of the market as the dealer in the subject transaction, timeliness of the information, and, with respect to the final factor listed above, the relative spread of the quotations in the similar municipal security to the quotations in the subject security).

(vii) Finally, if information concerning the prevailing market price of the subject municipal security cannot be obtained by applying any of the above factors, dealers (and the regulatory agencies and organizations responsible for enforcing MSRB rules) may consider as a factor in assessing the prevailing market price of a municipal security the prices or yields derived from economic models (e.g., discounted cash flow models) that take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (e.g., coupon frequency and accrual methods).

(viii) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. For example, in considering the pricing information described in (a)(v), a dealer may give due regard to whether such pricing information is being derived from an isolated transaction or quotation. In addition, in considering yields of “similar” municipal securities, except in extraordinary circumstances, dealers may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in “similar” municipal securities taken as a whole.

(b) “Similar” Municipal Securities

(i) A “similar” municipal security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the municipal security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the “similar” security or securities. Where a municipal security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

(ii) The degree to which a municipal security is “similar,” as that term is used in this Supplementary Material .06, to the subject security may be determined by factors that include but are not limited to the following:

(1) Credit quality considerations, such as whether the municipal security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as “similar” securities, significant recent information concerning either the “similar” security’s issuer or subject security’s issuer that is not yet incorporated in credit ratings should be considered (e.g., changes to ratings outlooks));

(2) The extent to which the spread (i.e., the spread over U.S. Treasury securities of a similar duration) at which the “similar” municipal security trades is comparable to the spread at which the subject security trades;

(3) General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the structure, callability, the likelihood that the municipal security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security;

(4) Technical factors such as the size of the issue, the float and recent turnover of the issue, and legal restrictions on transferability as compared with the subject security; and

(5) The extent to which the federal and/or state tax treatment of the “similar” municipal security is comparable to such tax treatment of the subject security.

(iii) When a municipal security's value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, pricing information with respect to other securities may not be used to establish the prevailing market price.