



FINANCIAL
SERVICES
ROUNDTABLE

Submitted electronically

January 20, 2015

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, Virginia 22314

Re: MSRB Regulatory Notice 2014-20, Request for Comment on Draft MSRB Rule G-15 Amendments, on Same-Day Pricing Information for Municipal Securities Transactions

Dear Mr. Smith:

The Financial Services Roundtable¹ (“FSR”) appreciates the opportunity to comment on the Municipal Securities Rulemaking Board’s (“MSRB”) proposed amendments to MSRB Rule G-15 (“Proposed Amendments”), as set forth in Regulatory Notice 2014-20 (“Regulatory Notice”), which would require disclosure on retail customer confirmations of pricing information for same-day transactions in municipal securities. The confirmation disclosure requirement would apply whenever a municipal securities dealer executes transactions in municipal securities as principal and also effects one or more transactions with a customer in the same security on the same day, provided that the transactions are “retail-size.”²

¹ *As advocates for a strong financial future*TM, the Financial Services Roundtable represents the largest integrated financial services companies providing banking, insurance, payment, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America’s economic engine, accounting directly for \$ 92.7 trillion in managed assets, \$1.2 trillion in revenue, and 2.3 million jobs. Learn more at FSRoundtable.org.

² *See* MSRB Regulatory Notice 2014-20, Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations, at 9 [hereinafter “Regulatory Notice 2014-20”].

The stated purpose of the Proposed Amendments is to increase transparency by providing customers with “meaningful and useful information” about the price differential between what a municipal securities dealer pays for a security and what it charges the customer for that same security.³ Specifically, it responds to concerns raised in 2012 by the Securities and Exchange Commission (“SEC”) regarding firms’ mark-ups and mark-downs on securities.⁴ We note that the Financial Industry Regulatory Authority (“FINRA”) is proposing similar amendments to its Rule 2232,⁵ and that the MSRB and FINRA are coordinating their respective rulemaking initiatives. Given the nature of the proposed amendments to confirmation disclosures, FSR believes regulatory coordination is essential, and we commend the MSRB and FINRA for these efforts.

FSR’s members greatly appreciate efforts to create meaningful transparency in the municipal securities markets; however, they do not believe that the Proposed Amendments are likely to achieve that objective. Rather, the Proposed Amendments would provide retail customers with information that is at best confusing and at worst misleading. In the process, the Proposed Amendments would impose significant and unwarranted costs on municipal securities dealers, which would be required to reprogram their confirmation and trading systems, redesign their confirmation forms to squeeze the proposed new disclosure onto trade confirmation forms that lack—as a practical matter—sufficient space to incorporate the proposed disclosure, and undertake costly accounting measures. Many of the costs might be passed along to retail customers, who would face higher fees without any real corresponding benefit. As a result, FSR urges the MSRB to abandon the Proposed Amendments.

I. Executive Summary

FSR urges the MSRB to abandon the Proposed Amendments for the following reasons:

- Implementation of the Proposed Amendments would not provide retail customers with meaningful and useful information about transaction costs for municipal securities.
- The Proposed Amendments would impose an unworkable burden on firms to sort through thousands of transactions in real-time to capture, analyze, and report information that, in many cases, would provide retail customers with an inaccurate picture concerning execution costs for municipal securities.
- There is a significant risk that the proposed disclosure, absent extensive disclosure, would mislead retail customers about their municipal securities dealers’ mark-ups or mark-downs on their specific municipal securities trades, because the proposed disclosure would not reflect a complete and accurate picture of all of the factors (including market events) that go into the price paid or received by the retail customer.

³ *Id.* at 13.

⁴ *Id.* at 4.

⁵ *See* FINRA Regulatory Notice 14-52, Pricing Disclosure in the Fixed Income Markets.

- FSR urges the SEC, the MSRB, and FINRA to work with the industry and consumer advocates to develop effective educational tools for retail customers that would be designed to increase the retail customers' understanding of the way that municipal securities transactions are effected.
- Reprogramming customer confirmation forms to implement the disclosures required by the Proposed Amendments would entail substantial costs for municipal securities dealers that may ultimately be passed along to retail customers, thereby increasing retail customers' fees without any corresponding increase in meaningful disclosure to retail customers.
- The Proposed Amendments are overly inclusive and would apply regardless of whether the firm makes or loses money on transactions it executes as principal and even if the principal and retail customer transactions are executed at exactly the same price.
- Although FSR believes the MSRB should abandon its Proposed Amendments, if the MSRB and FINRA proceed to implement these or similar initiative, FSR urges the MSRB and FINRA to coordinate their efforts to ensure the uniformity and consistency of the rules (and their interpretative guidance) in order to minimize disruption.

II. Introduction

FSR's members have a number of concerns relating to the feasibility of capturing the information that would be required to be disclosed under the Proposed Amendments, the usefulness of such information to customers, the overinclusiveness of the Proposed Amendments, and the costs that would be imposed on firms without any corresponding benefits for retail customers.

- i. Difficulty capturing the information. It is not uncommon for firms to engage in multiple principal transactions and multiple customer transactions in the same municipal security on the same day. The Proposed Amendments themselves do not provide any guidance or standardization that would take into account these realities. Rather, they merely suggest as possibilities "disclosing the trade that is closest in time proximity to the customer trade; disclosing the last principal trade that preceded the customer trade (a last in, first out (LIFO) methodology); or disclosing the weighted average price of multiple trades."⁶ Capturing this information in real time is impractical and overly burdensome.
- ii. Confusion. Because of the difficulty in capturing the relevant information, there is a high likelihood that the reference prices that would be disclosed would be inaccurate or misleading. Even setting aside the difficulty of capturing the appropriate reference prices, there is also a significant risk that retail customers would conflate price differentials with mark-ups and mark-downs. For instance,

⁶ Regulatory Notice 2014-20 at 11.

if the principal transaction occurs at the beginning of the trading day and the customer transaction occurs at the end of the day, any number of unrelated market events could be responsible for the price differential. However, the Proposed Amendments do not provide retail customers with any basis for evaluating that possibility. Finally, the Proposed Amendments would require the disclosure of the reference pricing information too late in time for it to be useful and would not provide any basis for retail customers to evaluate or contextualize the information.

- iii. Cost. As the MSRB is aware, reprogramming customer confirmation systems and redesigning the confirmations themselves is a time-consuming and expensive process. This large financial burden is not offset by any meaningful benefit to retail customers in light of the likelihood of retail customer confusion that would result from the somewhat *ad hoc* disclosure requirements.
- iv. Overinclusiveness. The Proposed Amendments would apply regardless of whether the firm makes or loses money on retail customer transactions it executes as principal; they would even apply if the principal and retail customer transactions were executed at exactly the same price. Moreover, they would apply whether the principal and customer transactions are seconds or hours apart and without regard to whether they are “riskless.” Such overbreadth imposes unnecessary costs.
- v. Uniformity. If the MSRB and FINRA ultimately adopt the respective proposals, we urge the MSRB and FINRA to ensure the uniformity and consistency of the rules (and their interpretative guidance) in order to minimize disruption.

II. Difficulty Capturing the Information

The Proposed Amendments would impose an unworkable burden on firms to sort through thousands of transactions in real time to capture, analyze, and report information that, in many cases, would provide retail customers with an inaccurate picture concerning execution costs for municipal securities. The premise of the Proposed Amendments is that there should be a way for retail customers to determine the difference between what they paid for municipal securities and what their municipal securities dealer paid for those same securities.

The Proposed Amendments might make sense in a market where the standard practice worked along the following lines: Firm buys X ABC bonds from a dealer and immediately sells X ABC bonds to a customer; Firm then buys Y DCE bonds from a dealer and immediately sells Y DCE bonds to a customer; and so on. However, the realities of the markets are far more complicated. Firms do not build and sell positions in municipal securities on a paired transaction basis. There is simply no meaningful way for a firm to match in an efficient and price-effective manner the securities sold to customers with particular securities that it has in its inventory or to match securities purchased from customers with securities that it sells in principal transactions.

The Proposed Amendments are silent about the calculation methods that firms should use in order to ensure compliance. Although the Regulatory Notice suggests as possibilities a patchwork of weighted averages, LIFO accounting, and other approximations, these methods, apart from being confusing and costly to implement, only begin to capture the potential permutations that can exist in a market involving multiple customers and multiple transactions. For example, what would happen in a scenario where a municipal securities dealer purchases bonds from multiple dealers at the same time at different prices, and sells bonds to multiple customers at the same price at the same time. While municipal securities dealers could perhaps extrapolate from the suggested methodologies for deriving a reference price to include on a customer's confirmation, the information provided would be somewhat of an arbitrary estimate and could mislead investors as to how their municipal securities dealers actually trade and derive the price to their customers.

Additionally, capturing the information and incorporating it into the confirmation process would make it difficult for municipal securities dealers to deliver confirmations in a timely manner. For example, municipal securities dealers will need processes for identifying the relevant principal transaction or transactions for each retail municipal securities trade in accordance with the MSRB's methodology, tagging each principal trade to prevent duplicative matches, calculating the price differential, and submitting the data to their confirmation systems (which in many cases are third-party service providers) for inclusion on each retail customer's written trade confirmation. FSR believes that this process will take hundreds of hours and be impossible to complete in order to deliver confirmations to retail customers prior to trade settlement. Even if the MSRB continues to believe that reference pricing information should be available to retail customers, FSR submits that requiring this disclosure on trade confirmations is not the appropriate vehicle.⁷

III. Confusion

The objectives of the Proposed Amendments are only served if investors receive useful information. However, the Proposed Amendments are not reasonably calculated to achieve that goal. Indeed, there is a significant risk that the information provided to retail customers would mislead them about their municipal securities dealers' mark-ups or mark-downs on their specific transactions because it would not—and could not in a timely and cost-effective way—provide a complete and accurate picture of all of the factors, including market events, that go into the price paid or received by a retail customer.

For instance, other factors, including market events, might be responsible for price differentials. Nonetheless, the Regulatory Notice characterizes the Proposed Amendments as disclosure regarding mark-ups and mark-downs, which could mislead retail customers into thinking that a particular municipal securities dealer's mark-up or mark-down is the primary factor in determining a customer's transaction price for a specific municipal security. For instance, mark-ups and mark-downs will be shown in a vacuum without reference to whether it

⁷ Some possible alternatives are discussed in Part III of this letter.

took the municipal securities dealer five seconds or five hours to execute the trade. Nor will the Proposed Amendments facilitate accurate comparisons of transaction costs for municipal securities across firms.

A more useful alternative would be for the SEC, the MSRB, FINRA, the industry, and consumer advocates to develop effective educational tools for retail customers that would be designed to increase retail customers' understanding of the way that municipal securities transactions are effected. This could include efforts to increase retail customers' awareness of tools that already exist to determine much of the information that would be disclosed under the Proposed Amendments. For instance, the Regulatory Notice observes that under the status quo, "[w]ith the use of information disseminated through these [free online] platforms, investors can make a more informed evaluation of the price paid or received for their municipal securities."⁸ Indeed, the promise of such publicly available information was the very reason the SEC decided not to move forward with proposals to increase confirmation disclosure requirements for municipal and other fixed income securities the last time it considered the issue, which was in 1994.⁹ Since then, EMMA (along with FINRA's tool TRACE) has made dramatic strides in increasing transparency. To the extent that the MSRB is concerned that not enough retail customers are aware of these resources, this can be solved through increased education. To the extent that the concern is that more information should be available online, that can be corrected as well without requiring municipal securities dealers to undertake the burdensome process of updating confirmation disclosures in the way that would be required under the Proposed Amendments.

Municipal securities dealers could supplement these efforts by providing a toll-free telephone number that their retail customers can use to obtain information about how their municipal securities dealer handles municipal securities trades generally, including the mark-up or mark-down charged on any particular transaction. Alternatively, if the MSRB believes that it is necessary for additional information to appear on confirmations, it could require firms to disclose the maximum mark-up/mark-down percentage that the firm permits and direct customers to the toll-free number if they have any additional questions.

IV. Cost

FSR estimates that the cost of implementing the Proposed Amendments would be significant. The most significant cost would be reprogramming confirmation forms. As the MSRB is aware, this is a time-consuming and expensive process. For instance, as part of a 2010 proposal to change mutual fund disclosures, the SEC estimated that the changes to the confirmation forms alone would take in excess of a million hours and would cost upwards of

⁸ Regulatory Notice 2014-20 at 6.

⁹ See Confirmation of Transactions, Securities Exchange Act Rel. No. 34962, 1994 SEC LEXIS 3503, at *4-5 (Nov. 10, 1994) (basing decision to defer consideration of proposals based on MSRB's commitment to develop "significant new ways of making pricing information more widely available to investors").

\$250 million.¹⁰ These are substantial costs that may ultimately be passed along to retail customers, thereby increasing their fees without providing meaningful disclosure. The alternatives proposed here would be far less costly, but would still achieve the goal of making more information about municipal securities available to retail investors.

V. Overinclusiveness

The Proposed Amendments are overly inclusive in a number of ways. For instance, they would apply regardless of whether the firm makes or loses money on transactions it executes as principal; they would even apply if the principal and retail customer transactions are executed at exactly the same price. This approach subjects firms to the burdens of the Proposed Amendments without any analysis of whether the information disclosed is likely to be of any utility to the customer.

The SEC's 2012 report only recommended disclosure for "riskless principal" trades.¹¹ However, the Proposed Amendments go beyond that recommendation and encompass all trades that occur within the same day. Even if the MSRB ultimately requires greater confirmation disclosure, such an expansive approach is not necessary.

VI. Uniformity

If the MSRB and FINRA ultimately move forward with their respective proposals, FSR urges the MSRB and FINRA to ensure the uniformity and consistency of the rules (and their interpretative guidance) in order to minimize disruption.

For instance, both regulators should use the same terminology to refer to third-party transactions. Currently, the MSRB uses the term "reference transactions." It would be helpful for FINRA to adopt the same term, or for both regulators to agree on some alternative that would be the same for both of them.

More importantly, the regulators should work together to ensure that the standards are the same for when disclosure is required and that the methodologies and accounting methods are standard and consistent. A failure to ensure uniformity would impose even greater costs on firms by requiring them to reprogram their confirmations according to two separate protocols.

¹⁰ See Mutual Fund Distribution Fees; Confirmations, 75 Fed. Reg. 47064, 47126 (Aug. 4, 2010).

¹¹ See Regulatory Notice 2014-20 at 4.

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FSR appreciates the opportunity to comment on the MSRB's Proposed Amendments. If it would be helpful to discuss FSR's specific comments or general views on this issue, please contact Richard Foster at Richard.Foster@FSRoundtable.org or Felicia Smith at Felicia.Smith@FSRoundtable.org.

Sincerely yours,



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