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January 20th, 2015

SENT VIA ELECTRONIC SUBMISSION

Marcia E. Asquith  
Office of the Corporate Secretary  
Financial Industry Regulatory Authority  
1735 K Street, NW  
Washington, DC 20006-1506

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

**RE: FINRA Regulatory Notice 14-52 and MSRB Regulatory Notice 2014-20**

Dear Mr. Smith and Ms. Asquith:

Interactive Data appreciates the opportunity to comment on the coordinated rule proposals FINRA 14-52 and MSRB 2014-20, concerning the disclosure of pricing information on retail fixed income transactions published November 17, 2014. We support the overarching goal of increased transparency for fixed income investors and the commitment of the Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB) in this area. The goal of increased transparency should balance the costs to the industry with the utility of the proposed disclosures to investors, while minimizing any deleterious effects to the fixed income markets.

Interactive Data is not a broker/dealer, and therefore is not well positioned to comment on many of the questions posed in the releases, such as those concerning the mechanics of confirmation statement generation. Rather, our comments focus on our observations regarding transaction costs in fixed income markets and the usability of the proposed disclosures to retail investors. We find that while the proposals would generate additional information for retail investors, these investors would continue to lack the necessary context or insight to be able to interpret that



information. As a result, we suggest alternative disclosures and methods of communication with retail investors be explored.

Interactive Data provides independent evaluations to over 5,000 global organizations, including banks, brokers, insurance firms, hedge funds and mutual funds. These evaluations underpin many facets of the fixed income investment lifecycle, ranging from trading, OMS and portfolio analytics platforms (such as our own BondEdge analytics solutions), to performance, risk and compliance systems, as well as portfolio accounting and NAV calculation processes. The foundation of our approach to evaluating 2.7 million instruments lies in the combination of our extensive set of market data (including FINRA's TRACE<sup>®</sup> and the MSRB Real-time Transaction Reporting System, along with additional pre-trade information sourced from both the sell side and buy side), our rich set of models, and the expert oversight provided by an Evaluated Services team of approximately 200 professionals. More recently, Interactive Data has developed Continuous Fixed Income Evaluations, producing an intraday streaming fixed income evaluation service that can assist with pre-trade price discovery and post-trade performance analysis among other applications.

Interactive Data's immersive evaluations approach makes us a keen observer of fixed income market trends, including shifting patterns in trade size and frequency. To help communicate our perspective based on these market surveillance activities, we have recently undertaken a 2010-2014 update to our previous, external transaction costs white paper from 2010. Both papers are available on the Interactive Data website<sup>1</sup> and will be referenced throughout this letter. Our comments in this letter derive from our role as an independent market observer and our associated understanding of the expertise that is required to assess and translate such transaction cost data.

As noted above, the recent paper "Transaction Costs in the Corporate, Municipal and Agency Bond Markets, 2010-14" updates Interactive Data's prior white paper "Corporate and Municipal Bond Trading Costs During the Financial Crisis" published in 2010. The 2014 paper examines patterns of transaction costs over time, for both paired and unpaired trades, by employing three different measurement approaches. The paper concludes that:

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<sup>1</sup> See "Corporate and Municipal Bond Trading Costs During the Financial Crisis" by Ciampi and Zitzewitz, 2010 and "Transaction Costs in the Corporate, Municipal and Agency Bond Markets, 2010-14 by Zitzewitz, 2014. <http://go.interactivedata.com/rs/idglobalcrm/images/Corporate-and-Municipal-Bond-Trading-Costs-During-the-Financial-Crisis-Aug-2010.pdf>  
<http://go.interactivedata.com/Transaction-Costs-Jan-2015-Web-WPR.html>

- Transaction costs for the period of 2010-14 were both relatively stable<sup>2</sup> and generally lower than they were during the credit crisis<sup>3</sup>.
- Small, intra-period increases in transaction costs were also noted during periods of volatility for particular asset classes, such as in late 2011 for corporate bonds.<sup>4</sup>
- Paired-bond activity, suggesting riskless principal transactions, was also prevalent, although transaction costs for both paired and unpaired dealer-client transactions were similar.<sup>5</sup> However, an examination of the distribution of transaction costs within size bands illustrates clear asymmetry with a larger 90<sup>th</sup>-50<sup>th</sup> percentile difference for client buys and a larger 50<sup>th</sup>-10<sup>th</sup> percentile difference for client sells.<sup>6</sup>
- Interdealer trades that are paired with client trades reflect transaction costs that are about half of those paid by clients.<sup>7</sup>
- Transaction costs exhibit a direct relationship with length to maturity and an inverse relationship with credit quality.
- Average transaction costs for smaller trades continue to be higher than for larger trades. However, it was noted that transaction costs for very small trades (less than \$10,000) are no larger than those in the \$10k-50k range.
- The 2014 paper also compares the differences in transaction costs observed when using Continuous Fixed Income Evaluations<sup>8</sup> (updated on a streaming basis throughout the trading day) and finds that by eliminating the ‘noise’ introduced by overnight bond movements, the measurement error is reduced significantly and the length of the tails decrease. In other words, transaction costs, when measured against a valuation benchmark on an intraday basis, tend to exhibit a tighter distribution<sup>9</sup>.

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<sup>2</sup> See figures 11 and 12 from the 2014 paper.

<sup>3</sup> Although the methodologies are not exactly the same, these patterns can be generally observed by comparing 2010 with 2008-9 in Tables 3A and 3B of the 2010 paper and comparing 2010 with 2011-14 in Figures 5A and 5B of the 2014 paper

<sup>4</sup> See page 8, and Figures 11 and 12 of the 2014 paper.

<sup>5</sup> See Tables 2A, 2B and 2C as well as Figures 2A, 2B and 2C of the 2014 paper.

<sup>6</sup> See Tables 4A-4D and Figures 4A-4D of the 2014 paper.

<sup>7</sup> See Tables 2A-2C of the 2014 paper.

<sup>8</sup> Interactive Data launched Continuous Fixed Income Evaluations in 2014. For additional information, please refer to [http://www.interactivedata.com/Assets/DevIDSite/PDF/InteractiveData\\_Continuous-Evaluated-Pricing.pdf](http://www.interactivedata.com/Assets/DevIDSite/PDF/InteractiveData_Continuous-Evaluated-Pricing.pdf)

<sup>9</sup> This reduction in distribution can be seen by comparing Figures 4A and 4D as well as Tables 4A and 4D from the 2014 paper.

Taken together, we believe the findings outlined above highlight the compound nature of fixed income transaction cost variability. These costs tend to differ not only according to the size of the trade, but by bond characteristic (distance to maturity, credit quality, recency of issuance, relative liquidity), by market conditions (especially volatility) as well as by trading partner and execution method.

The rule changes detailed in FINRA release 14-52 and MSRB release 2014-20 generally propose that for certain retail-sized trades (mainly \$100k or less), additional information concerning same-day offsetting trades be provided to the client as part of the confirmation statement. The underlying rationale is that having this information will enable the retail investor to understand the effective mark-up or mark-down realized by their broker/dealer, allowing the client to discern the reasonableness of the transaction cost and execution price. However, given the complexities of the bond market and the variability of transaction costs described above, it seems unlikely that the average retail investor (who does not trade frequently and is not expert in fixed income markets) will be able to interpret the new mark-up or mark-down information. For example, on a \$50,000 transaction, an effective one point mark-up might be a very low transaction cost for the purchase of a 15 year, high-yield corporate, but the same one point mark-up would be relatively expensive for the purchase of a 5 year, high-grade municipal. It is hard to imagine, absent some form of additional market context, that a casual retail investor would have the baseline knowledge necessary to understand this transaction cost data.

We believe alternative approaches should be considered that offer meaningful context and therefore permit the retail investor to better understand the transaction cost and execution price. As proffered in both the MSRB<sup>10</sup> and FINRA<sup>11</sup> releases, we believe that third-party prices can be leveraged to better inform retail investors. In particular, an accepted, intra-day benchmark valuation for a specific security, displayed with an illustration of the likely range of expected variation in trades (factoring in size of transaction), would offer the retail client meaningful information about their trade. With these additional details, the aforementioned investor in a 15 year, high-yield corporate bond would be able to observe that their execution was clearly within

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<sup>10</sup> See page 15 of MSRB's 2014-20 release - "The MSRB could also require the inclusion of other market information (e.g., prices provided by external pricing services) on the confirmation. The MSRB seeks comments on whether any of these alternatives provide customers with more meaningful and useful information, whether that value of additional information can be quantified, and the degree to which any of these alternatives would be more or less costly to implement."

<sup>11</sup> See page 12 of FINRA's 14-52 release - "Rather than using the price to the firm, would the best available representation of current market price be more useful... If so, given the infrequent trading in many bonds, what would be an acceptable reference price to use to measure the current price?"



the expected range of prices, while the investor in a 5 year, high-grade municipal bond could see that their execution fell outside of the expected range. Furthermore, it is possible that such an approach – if available as an alternative to the proposed display of offsetting trades - could be less costly for firms to implement, particularly if industry participants were to provide the information via a website link.

Further detail on information that could be made available for retail clients as part of an alternative approach is included as an appendix. These screens are not meant to specifically represent investor-ready information, but are included to help illustrate the possible direction that such an approach could take. The underlying data and delivery mechanisms necessary to deliver such clarifications exist now and could be rolled out to broker/dealers.

Interactive Data appreciates the opportunity to comment on these rule proposals and welcomes further discussion concerning the information provided.

Sincerely,

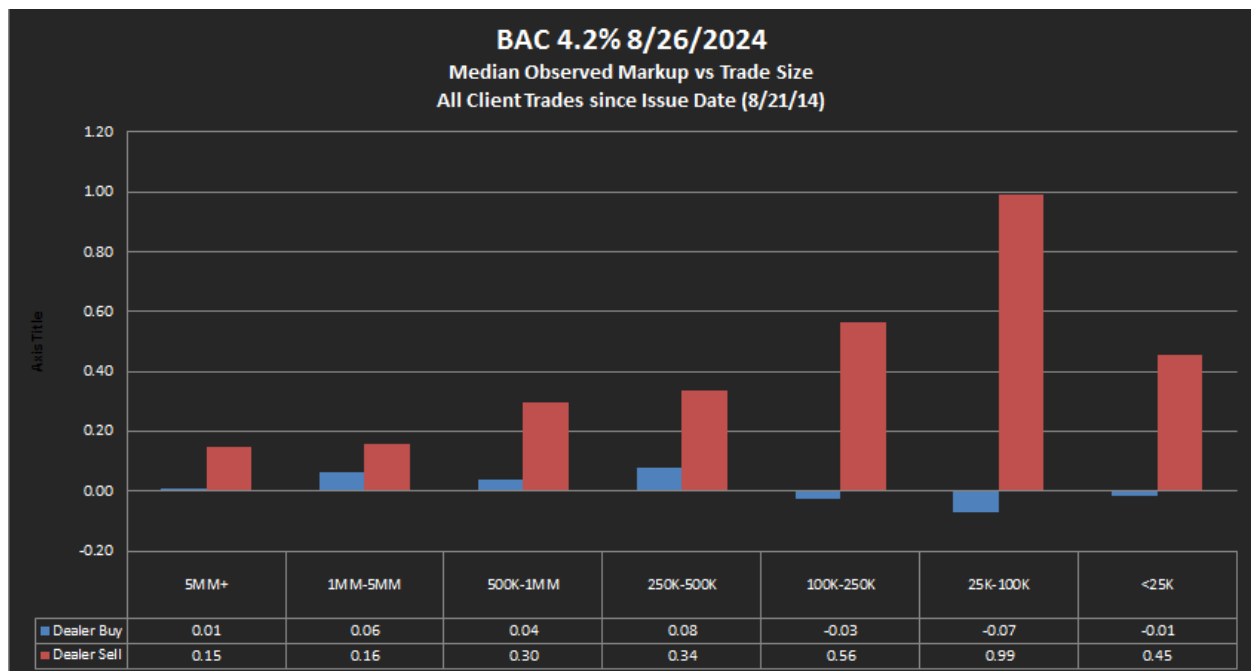
A handwritten signature in black ink, appearing to read "Andrew Hausman". The signature is written in a cursive, flowing style.

Andrew Hausman

President, Pricing & Reference Data

**Appendix:**

*Figure 1*



*Figure 1* displays an example of observed mark-ups by trade size for Bank of America’s 4.2% bond maturing on 8/26/2024. The size of the markup was estimated as the median difference between the transaction price reported to FINRA’s TRACE® system and the corresponding bid side of Interactive Data’s Continuous Fixed Income Evaluated Price (CEP). The consistently low deviations for dealer buys suggests that, in the absence of an actual transaction, the continuous evaluated bid price provides a representative benchmark for a dealer’s acquisition cost and, by extension, the transaction cost incurred by investors when they buy bonds.

We believe retail investors would be more likely to understand the cost of fixed income trades if the reference price presented with each trade captured the collective experience of investors. For this particular bond, half of the buyers making purchases between \$25,000 and \$100,000 were charged no more than \$0.99 above the price at which dealers would be able to buy the bond.

Figure 2

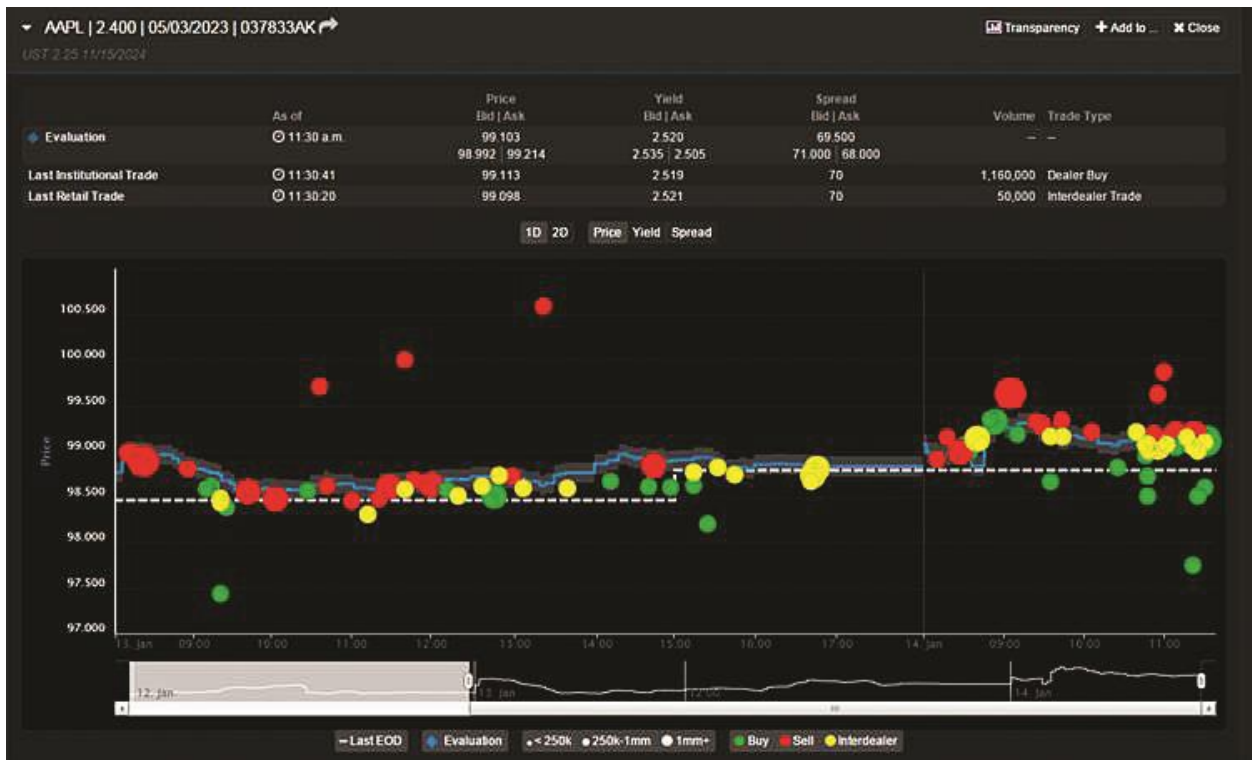


Figure 2 displays an illustration of Apple’s 2.4% bond maturing on 5/3/2023. The blue line display’s Interactive Data Continuous Fixed Income Evaluations for this particular security, while the red circles indicate dealer-to-client sells (the circle’s area corresponds to the size of trade), the green circles indicate dealer-from-client buys and the yellow circles show intra-dealer trades.