MSRB
Municipal Securities Rulemaking Board

November 14, 2016

Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Response to Comments on SR-MSRB-2016-12

Dear Secretary:

On September 2, 2016, the Municipal Securities Rulemaking Board ("MSRB") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to MSRB Rule G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers, and Rule G-30, on prices and commissions, to require disclosure of the mark-up or mark-down on certain principal transactions and to provide guidance on prevailing market price (the "proposed rule change"). The MSRB believes that retail investors are currently limited in their ability to assess and compare transaction costs associated with the purchase or sale of municipal securities, and that requiring dealers to disclose their mark-ups and mark-downs on retail customer confirmations would provide meaningful and useful pricing information and may result in lower transaction costs for such investors. The MSRB also believes that additional guidance on establishing the prevailing market price and determining mark-ups and mark-downs would promote consistent compliance by dealers with their existing fair-pricing obligations under MSRB rules and would support effective compliance with the proposed amendments to Rule G-15. The SEC published the proposed rule change for comment in the Federal Register on September 13, 2016[1] and received eight comment letters.[2]

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1 See Exchange Act Release No. 78777 (Sept. 7, 2016), 81 FR 62947 (Sept. 13, 2016).

2 See letters from Michael Nicholas, Chief Executive Officer, Bond Dealers of America, dated October 4, 2016 ("BDA"); Norman L. Ashkenas, Chief Compliance Officer, Fidelity Brokerage Services, LLC, and Richard J. O'Brien, Chief Compliance Officer, National Financial Services, LLC, dated October 4, 2016 ("Fidelity"); Mary Lou Von Kaenel, Managing Director, Financial Information Forum, dated October 4, 2016 ("FIF"); Paige W. Pierce, President and Chief Executive Officer, RW Smith & Associates, LLC, dated October 4, 2016 ("RW Smith"); Leslie M. Norwood, Managing Director and Associate General Counsel, and Sean Davy, Managing Director, Capital Markets Division, Securities Industry and Financial Markets Association, dated October 3, 2016 ("SIFMA"); Manisha Kimmel, Chief Regulatory Officer, Wealth Management, Thomson Reuters, dated September 19, 2016 ("Thomson"); Robert J. McCarthy, Director

To inform its development of the proposed rule change, the MSRB sought public comment on draft amendments in three separate requests for comment.[3] In response to the requests for comment, the MSRB received a total of sixty-three letters from a diverse group of commenters. Some commenters expressed support for the draft amendments. Others generally supported the MSRB's efforts to enhance transparency for retail investors in municipal securities, but expressed various concerns or suggested revisions. The MSRB found this input to be highly informative and valuable. After carefully considering the comments received in response to each request, the MSRB made significant revisions to the draft amendments before filing the proposed rule change with the Commission.[4] This letter responds to the eight comment letters received by the Commission.

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of Regulatory Policy, Wells Fargo Advisors, LLC, dated October 4, 2016 ("Wells Fargo"), and Memorandum to the Commission from Rick A. Fleming, Investor Advocate, SEC, dated November 7, 2016 ("SEC Investor Advocate").

3 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) (the "initial proposal"); Request for Comment on Draft Rule Amendments to Require Confirmation Disclosure of Mark-ups for Specified Principal Transactions with Retail Customers, MSRB Notice 2015-16 (Sept. 24, 2015) (the "revised proposal"); and Request for Comment on Draft Amendments to MSRB Rule G-30 to Provide Guidance on Prevailing Market Price, MSRB Notice 2016-07 (Feb. 18, 2016) (collectively, the "requests for comment").

4 Generally, under the proposed rule change, if a dealer trades as principal with a non-institutional customer in a municipal security, the dealer must disclose the dealer's mark-up or mark-down from the prevailing market price for the security on the customer confirmation, if the dealer also executes one or more offsetting principal transaction(s) on the same trading day as the customer, on the same side of the market as the customer, in an aggregate size that meets or exceeds the size of the customer trade. The mark-up or mark-down would be required to be determined in compliance with Rule G-30 and the supplementary material thereunder, including the prevailing market price guidance in proposed new Supplementary Material .06.

Generally, under the guidance, the prevailing market price of a municipal security presumptively would be established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained. If this presumption is overcome or inapplicable, the prevailing market price would be determined by referring in sequence to: (1) a hierarchy of pricing factors, including contemporaneous inter-dealer and institutional transaction prices, and if an actively traded security, contemporaneous quotations; (2) prices or yields from similar securities; and (3) economic models.

In addition, after carefully considering, and in response to, the comments, the MSRB is filing this day Amendment No. 1 to SR-MSRB-2016-12 ("Amendment No. 1") to make certain changes as discussed below and in further detail in Amendment No. 1.

Consistent with the comments received in response to the requests for comment, commenters on the proposed rule change generally expressed their continued support for greater transparency in the municipal securities market. In addition, commenters were supportive of various modifications and/or clarifications included in the proposed rule change or provided in the filing supporting the proposed rule change that were made in response to prior comments received by the MSRB. For example, SIFMA supported the MSRB's approach to determining the mark-up and mark-down when a dealer has a contemporaneous cost or contemporaneous proceeds from a customer transaction. However, commenters urged additional modifications or clarifications, as discussed below.

Trigger Requirements for Mark-up Disclosure. FIF and Thomson raised questions about the mechanics and potential complexity of the same-day mark-up disclosure trigger. They noted that the proposed rule change would require dealers to develop a matching logic that considers trades that may occur before and after a customer trade. Thomson noted that while dealers may avoid operational costs associated with the same-day mark-up disclosure trigger by voluntarily providing mark-up disclosure on all non-institutional customer trade confirmations, dealers may be hesitant to make such additional voluntary disclosures unless they can include statements on confirmations to explain or qualify the nature of the mark-up disclosure.

As stated in the proposed rule change, the MSRB recognizes that dealers would incur costs to identify trades subject to the disclosure if dealers do not voluntarily disclose on all principal trades with non-institutional customers. Nonetheless, the MSRB continues to believe that disclosure based on a same-day trigger would deliver important benefits associated with increased pricing transparency.[5] The MSRB included guidance in the filing supporting the proposed rule change that was intended to facilitate the timing of the mark-up determination for dealers that voluntarily determine to provide mark-up disclosure more broadly. Additionally, the MSRB addresses below the request from Thomson and others on the ability to provide explanatory or qualifying statements concerning disclosed mark-ups.

SIFMA incorporated by reference in its comment letter to the SEC its comment letter on the FINRA proposed rule change. In its comment letter on the FINRA proposed rule change, SIFMA sought confirmation for its interpretation that the FINRA proposed rule change requires disclosure only in cases where a customer trade has an offsetting principal trade. Because FINRA and the MSRB used similar rule text to describe the mark-up disclosure trigger, the MSRB confirms, with respect to the MSRB's proposed rule change, that there must be offsetting customer and principal trades in order to trigger a mark-up disclosure obligation. The MSRB notes that while the rule text in the proposed rule change did not explicitly use the term

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5 The SEC Investor Advocate expressed strong agreement with the proposed same-day triggering time frame.

"offsetting," the filing supporting the proposed rule change described the terms under which mark-up or mark-down disclosure would be required. In relevant part, the MSRB explained that disclosure is required where the dealer "executes one or more offsetting principal transaction(s) on the same trading day as the customer . . . ."[6] The MSRB is submitting Amendment No. 1 in part to ensure rule text clarity on this point by adding the word "offsetting" to the trigger language.[7] For example, if a dealer purchased 100 bonds at 9:30 AM, and then executed three customer buy orders for 50 bonds each in the same security on the same day without purchasing any more of the bonds, the proposed rule change would require mark-up disclosure on two of the three trades, since one of the trades would need to be satisfied out of the dealer's prior inventory rather than offset by the dealer's same-day principal transaction.

Time of Execution and Link to EMMA. Fidelity, FIF, Thomson and Wells Fargo recommended that the MSRB remove the requirement to disclose the time of execution and security-specific link from the proposed rule change, principally on the basis of greater harmonization between the MSRB's proposed rule change and a related mark-up disclosure proposed rule change for other fixed-income securities submitted by FINRA. Commenters noted that, while the MSRB's proposed rule change included a time of execution and link disclosure requirement, the related FINRA proposed rule change did not include such requirements. Rather, the FINRA proposed rule change included a statement that FINRA intended to file a separate subsequent proposal to require confirmation disclosure of the time of trade and a link to the Trade Reporting and Compliance Engine ("TRACE"). Commenters requested harmonization between the MSRB and FINRA so that this aspect of the proposed rule change and any forthcoming FINRA proposal on these matters could be evaluated concurrently. The SEC Investor Advocate also stated generally that it is important for the MSRB and FINRA to adopt consistent rules related to confirmation disclosure.

Commenters also expressed a belief that further consideration is warranted regarding these proposed disclosure requirements. For example, Fidelity questioned how dealers should implement the required time-of-execution disclosure in the case of adviser block-trade executions that are later allocated to retail customer accounts. FIF suggested that time of execution disclosure might be confusing to these types of retail customers. Fidelity also recommended that dealers should be permitted to combine the security-specific link disclosure with the official statement delivery obligation for primary issues under MSRB Rule G-32. BDA and Thomson expressed support for a requirement to disclose a general link to EMMA as opposed to the requirement in the proposed rule change to disclose a link to a security-specific page. These commenters were concerned that the web addresses to security-specific pages may change without the dealer's knowledge, potentially causing the dealer to include faulty links on

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6 81 FR at 62947.

7 The MSRB notes, however, that the proposed rule change is not meant to be drawn more narrowly to apply only to "matched trades" as SIFMA's comment might suggest. To the extent that "matched trades" is meant to imply that the principal and customer transactions must both be known to the dealer when it arranges the transactions, it would not accurately characterize the scope of the proposed rule change.

customer confirmations. Commenters also expressed concern that it is unlikely that customers would type the long uniform resource locator ("URL") associated with a security-specific link into an internet browser.

In response to the comments, the MSRB, in Amendment No. 1, has made minor technical amendments to the proposed rule change that, in addition to other benefits, would serve to align the MSRB and FINRA link and time of execution standards in all relevant, substantive and technical respects. The MSRB and FINRA have continued to coordinate closely regarding their respective mark-up disclosure initiatives, to achieve appropriate consistency. Today, FINRA filed with the SEC an amendment to its proposal to require the disclosure of the time of trade and a link to TRACE on non-institutional customer confirmations under generally the same conditions as set forth in the MSRB proposed rule change (the "FINRA link and time of trade amendment").[8] Specifically, both the MSRB and FINRA would require the disclosure of the time of trade or time of execution on non-institutional customer confirmations, regardless of whether the dealer would be required to disclose the mark-up or mark-down on the customer transaction. Additionally, for the same confirmations, the dealer must disclose a reference and hyperlink to a webpage on TRACE or EMMA, as applicable, that contains trading data for the specific security that was traded, along with a brief description of the type of information available on that page.

As explained in Amendment No. 1, in the interest of harmonization with FINRA and to potentially improve the experience for investors who access EMMA via a link on their confirmation, the MSRB has made a technical amendment to its proposed link disclosure requirement. Specifically, the MSRB is replacing the requirement for dealers to disclose a link to a specific existing page on EMMA—the "Security Details" page—with a more generic requirement to disclose a link to a webpage on EMMA, in a format specified by the MSRB, that contains publicly available trading data for the specific security that was traded. Thus, all printed confirmations for which the disclosure is required must include the URL to the applicable webpage, and all electronic confirmations for which the disclosure is required must include a hyperlinked URL to the applicable webpage. While this is a technical amendment that does not modify in any way the substantive link disclosure requirement originally proposed by the MSRB in the proposed rule change, the MSRB believes that the use of such language, which, based on coordination between the MSRB and FINRA, is similar to the language used by FINRA in its related proposal, is responsive to commenter requests for more harmonization and would reduce the potential for confusion. The MSRB also believes that by using slightly more general language to describe the link disclosure requirement, rather than codifying a requirement to link to a page with a specific title, the MSRB and FINRA can continue to consider ways to make the landing page for investors that access EMMA and TRACE via the link on confirmations potentially more retail investor friendly.

Also, as explained in Amendment No. 1, in the interest of harmonization with FINRA and to potentially provide some implementation relief for dealers that may not otherwise need to modify their confirmation systems to provide any disclosures under the proposed rule change to

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8 See Partial Amendment No. 1 (File No. SR-FINRA-2016-032) (Nov. 14, 2016).

institutional customers, the MSRB is proposing to require dealers to disclose the time of execution for only retail customer confirmations, rather than all retail *and institutional* confirmations. Because institutional customers are likely to know the time of execution of their transaction, the MSRB believes that the costs of requiring dealers to revise their confirmation systems for institutional investors to provide this disclosure to institutional customers may exceed the likely benefits of such disclosure.

With respect to comments about the implementation of the link and time of execution disclosure requirements, the MSRB has publicly stated its intention to develop a more succinct EMMA URL, which is now functional, for direct access to a security-specific page on EMMA.[9] The MSRB believes that this more succinct URL, which may be used in connection with the proposed disclosure, is more intuitive and would decrease the number of characters an investor may need to type to access the relevant page on EMMA.[10] The MSRB does not anticipate any future changes to the protocol for the succinct URL, and therefore, envisions that a link that follows the succinct URL format will continue to function indefinitely. However, if such protocol is modified in the future, the MSRB would fully inform dealers through the regulatory contacts identified to the MSRB and through other means.

The MSRB agrees that the disclosure of a security-specific link to EMMA would satisfy a dealer's official statement delivery obligation for primary issues under Rule G-32; provided, that the link and URL are also accompanied by the information required under Rule G-32(a)(iii). Lastly, the MSRB notes that the obligation to disclose the time of execution under the proposed rule change is not intended to modify the way a dealer would determine the time of execution.[11]

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9 A sample current URL to a security-specific page on EMMA is http://emma.msrb.org/SecurityView/SecurityDetails.aspx?cusip=160075vv6. In contrast, a sample succinct URL, which is now also operational, is http://emma.msrb.org/cusip/160075vv6. To avoid potential disruption for persons with existing page-specific bookmarks or direct links to EMMA pages, the longer current URLs will also continue to function.

10 The MSRB understands that the format of this succinct URL will be generally consistent with a succinct URL that FINRA may employ.

11 As explained in the filing supporting the proposed rule change, dealers have an existing obligation to report the "time of trade" to the MSRB's Real-Time Transaction Reporting System pursuant to Rule G-14, on reports of sales or purchases. In addition, dealers have an existing obligation to make and keep records of the time of execution of principal transactions under Rule G-8(a)(vii). The time of execution for proposed confirmation disclosure purposes is the same as the time of trade for Rule G-14 reporting purposes and the time of execution for purposes of Rule G-8(a)(vii), except that dealers should omit all seconds from the disclosure because the trade data displayed on EMMA does not include seconds.

Rather, it merely requires the dealer to affirmatively disclose this information to all non-institutional customers, rather than disclose such information only upon request.

Spread. BDA, SIFMA and RW Smith stated that the MSRB should revise the prevailing market price guidance to describe more accurately the concept of spread in the municipal market. The proposed rule change includes among its non-exclusive list of relevant factors to determine the degree to which a municipal security is similar "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." However, these commenters noted that only taxable municipal bonds trade at a spread to Treasuries and that the parenthetical described above should be revised to include language relevant to the appropriate spread relied upon for non-taxable municipal bonds.

The MSRB generally agrees and, as explained in greater detail in Amendment No. 1, is amending the proposed rule change to clarify that a dealer also may consider the extent to which the spread over the "applicable index" at which the similar municipal security trades is comparable to the spread at which the subject security trades.

Harmonized Approach. BDA, the SEC Investor Advocate, SIFMA, Thomson, Wells Fargo and RW Smith urged harmonization between the MSRB and FINRA regarding mark-up disclosure and prevailing market price guidance. While these commenters generally expressed an appreciation for the harmonization between the MSRB and FINRA to date, they urged more harmonization in the final rules. As several commenters acknowledged, it is apparent that the MSRB and FINRA have coordinated on this confirmation disclosure initiative, and the proposed rule change filed by the MSRB and the proposed rule change filed by FINRA are generally harmonized. The proposals differed significantly only with respect to the MSRB's proposed disclosure of a link to EMMA as well as the time of execution. As described above however, with the filing of the FINRA link and time of trade amendment, the MSRB and FINRA are generally aligned on these matters. In addition, as discussed above, the amendments included in Amendment No. 1, among other things, will fully align the FINRA and MSRB link and time of execution disclosure requirements in all significant substantive and technical respects.

Automation. BDA and SIFMA expressed concern about the technological difficulties in automating the prevailing market price determination. BDA explained that there is currently no commercially available technology solution for automating the process outlined in the guidance. SIFMA requested an express acknowledgement from regulators that it is not technologically feasible to automate the waterfall analysis.

As an initial matter, the MSRB notes that firms are not required to automate the prevailing market price determination to comply with the proposed rule change. However, the MSRB recognizes that, as a practical matter, many firms—particularly those that voluntarily disclose their mark-ups and mark-downs such that they are provided to all retail customers—may need to enhance existing technology to determine prevailing market price in a consistent and efficient manner.

The MSRB believes that some of the explanations included in the proposed rule change and discussed in more detail here, as well as some of the clarifications discussed below make the prevailing market price determination more amenable to programming for those firms that choose or have a need to do so. These include additional explanation regarding reasonable policies and procedures, the determination of "similar" securities[12] and guidance below regarding the use of third-party pricing services as "economic models." In addition, dealers that choose to engage a third-party service provider to document and perform the steps under the waterfall analysis would not be prohibited from doing so under the proposed rule change.[13] Still, the MSRB recognizes the potential challenges involved in implementing the proposed rule change and, as discussed in more detail below, has extended the proposed implementation period to allow dealers more time to establish systems and processes to comply.

Economic Models. Under the guidance, dealers may consider as a factor in assessing the prevailing market price of a security the prices or yields derived from economic models if information concerning the prevailing market price cannot be obtained by applying any of the factors at the higher levels of the waterfall. In the filing supporting the proposed rule change, the MSRB stated that, if a dealer relies upon pricing information from an economic model the dealer uses or has developed, the dealer must be able to provide information that was used on the day of the transaction to develop the pricing information (i.e., the data that was input and the data that the model generated and the dealer used to arrive at prevailing market price). While this statement applies to a model a dealer has developed or uses internally, it does not apply to a third-party model that a dealer uses by contracting with the third-party. Typically, a dealer would not have access to such information due to the level of confidentiality maintained by third-party services. Dealers are cautioned, however, that the ultimate responsibility to determine the market value of a security and ensure the fairness and reasonableness of a price and any related mark-up or mark-down under Rule G-30 lies with them. As a general matter, outsourcing an activity or function to a third party does not relieve dealers of their ultimate responsibility for compliance with all applicable federal securities laws and regulations regarding the outsourced activity or function.

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12 See Exchange Act Release No. 78777 (Sept. 7, 2017), 81 FR 62947, 62953 (Sept. 13, 2016); see also infra, "Policies and Procedures; Similar Securities."

13 However, as those dealers would retain compliance responsibility, it would be incumbent on them to perform the due diligence necessary to ensure that such a third-party service provider provides to the dealer figures that were determined in compliance with the prevailing market price guidance. Similarly, dealers would be expected to perform regular reviews of their policies and procedures for mark-up disclosure—whether the procedures document steps taken within a dealer's own operations or the dealer's oversight of third party vendors—to ensure they are adequate, appropriate, and consistently applied.

Before deciding to use evaluated prices from a pricing service to assist it in determining the prevailing market price of a municipal security, a dealer should have a reasonable basis for believing the third-party pricing service's pricing methodologies produce evaluated prices that reflect actual prevailing market prices.[14] A dealer would not have a reasonable basis for such a belief, for example, where a periodic review of the evaluated prices provided by the pricing service frequently reveals a substantial difference between such evaluated prices and the prices at which actual transactions in the relevant securities occurred. In conducting its due diligence on a pricing service, a dealer may wish to consider the inputs, methods, models, and assumptions used by the pricing service to determine its evaluated prices, and how these inputs, methods, models, and assumptions are affected (if at all) as market conditions change. In choosing to use evaluated prices from any pricing service, a dealer should assess, among other things, the quality of the evaluated prices provided by the service and the extent to which the service determines its evaluated prices on an intra-day basis.[15]

Applicability of the Guidance. RW Smith and SIFMA stated that the prevailing market price guidance included in the proposed rule change should apply solely for purposes of determining the mark-up or mark-down to be disclosed under the proposed rule change, and not as part of an overarching fair-pricing methodology under Rule G-30. These commenters explained that the prevailing market price guidance originated from a need to provide guidance to dealers in the context of a mark-up disclosure requirement, but that such guidance is not warranted for purposes of evaluating the fairness of a dealer's mark-up. SIFMA stated that, if the

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14 The dealer's supervisory system and written supervisory procedures should be appropriately tailored to reflect this outsourced function. Among other things, the dealer must have procedures regarding the dealer's outsourcing practice to ensure compliance with applicable securities laws and regulations and MSRB rules. The procedures should include, without limitation, a due diligence analysis of the third-party service provider to determine whether such party is capable of performing the outsourced services. Dealers should also ensure that an appropriately qualified person monitors the arrangement. Additionally, dealers should ensure that all applicable regulators have the same complete access to the pricing service's work product for the dealer, as would be the case if the covered activities had been performed directly by the dealer.

15 Recent money market fund regulatory changes by the SEC expressly contemplate money market funds use of evaluated prices provided by third-party pricing services to assist them in determining the fair value of portfolio securities. However, the SEC has affirmed that a fund's board of directors retains the ultimate responsibility to determine whether an evaluated price provided by a pricing service, or some other price, constitutes a fair value, and that the board of directors cannot delegate such responsibility. The guidance provided here by the MSRB on the use of pricing services is intended to be consistent with and draws significantly on the guidance provided by the SEC on money market funds. See Money Market Fund Reform; Amendments to Form PF, Release No. 33-9616; IA-3879; IC-31166 (July 23, 2014), 79 FR 47736, 47814-47815 (Aug. 14, 2014).

MSRB was not amenable to applying the prevailing market price guidance for disclosure purposes only, the guidance should apply only for non-institutional customers because, in SIFMA's view, such a limitation would be consistent with the terms of the proposed mark-up disclosure requirement and would more closely align the scope of the guidance with that of prevailing market price guidance adopted by FINRA.

The MSRB believes that a dealer that uses reasonable diligence to determine the prevailing market price of a municipal security in accordance with the guidance, and that discloses a mark-up based on such determination, should generally be able to rely on that determination when examined for the fairness of its pricing and mark-up. The MSRB also believes that it would be confusing for investors to learn that the mark-up or mark-down disclosed on their confirmations is systematically not necessarily the mark-up or mark-down against which the fairness of their dealer's mark-up or mark-down will be evaluated by regulators. Under the proposed rule change, there is only one significant departure from this general principle. As explained in the filing supporting the proposed rule change, a dealer may determine—as a final matter for disclosure purposes—the prevailing market price based on the information the dealer has (based on the use of reasonable diligence) at the time the dealer inputs the information into its systems to generate the mark-up disclosure amount for the trade for which the mark-up is disclosed.[16] Such timing of the determination of prevailing market price would avoid, as explained in the filing, potentially open-ended delays and would also permit dealers who, on a voluntary basis, choose to disclose mark-ups and mark-downs on all principal transactions to generate customer confirmations at the time of trade, should they choose to do so.

Assume, for example, a dealer systematically inputs the mark-up related information into its systems intra-day (e.g., at the time of trade) for the generation of confirmations. If such dealer purchases a security from a customer at 9:00 AM at a time when it has no contemporaneous proceeds, the dealer may, for disclosure purposes, proceed down the waterfall to determine the prevailing market price for that trade and thus its disclosed mark-down to the customer. For fair pricing purposes, however, if that same dealer later obtains "contemporaneous" proceeds for that

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16 See 81 FR at 62955. Thomson requested that the MSRB allow the determination of prevailing market price at the time of trade for all processes including for those that capture confirmation-related data in real-time, even if the actual issuance of the confirmation is not until the end of the day. As explained above, under the proposed rule change, a dealer may determine the prevailing market price as a final matter for disclosure purposes based on information the dealer has at the time the dealer inputs the information into its systems to generate the determination of mark-up disclosure amount. This is so even when the actual issuance of the confirmation is not until the end of the day. Of course, dealers must consistently apply their relevant policies and procedures in the same manner across non-institutional customers. Thus, for example, a dealer may not determine prevailing market price for some retail customers at the time of trade and selectively determine prevailing market price for other retail customers at the end of the day.

security, the dealer's prevailing market price in connection with the 9:00 AM transaction would presumptively be established by reference to the later contemporaneous proceeds.[17] The MSRB expects that any potential differences between a disclosed mark-up or mark-down to a customer under Rule G-15 and any mark-up or mark-down for fair pricing purposes under Rule G-30 typically will be small because the processes to arrive at the prevailing market price will be identical. While the timing of the determination of prevailing market price, and therefore the amount of mark-up or mark-down, would be different, a dealer would arrive at a different mark-up or mark-down for fair-pricing purposes only if new information relevant under the prevailing market price guidance arises.

The MSRB also has determined not to make the prevailing market price guidance inapplicable to transactions with institutional customers. The MSRB regulatory regime recognizes that certain investors may be sufficiently sophisticated as to warrant modified obligations owed to them. As it stands, these sophisticated municipal market professionals (SMMPs), may opt out of certain protections, including certain fair-pricing protections relating to agency, but not principal, transactions. The determination of prevailing market price is central to the fair-pricing determination in principal transactions. Because even SMMPs cannot opt out of the fair-pricing protections for principal transactions, the MSRB does not believe that it is appropriate to limit the prevailing market price guidance to transactions with non-institutional customers only.

Explanatory Language on Confirmations. BDA, Fidelity, SIFMA, Thomson and Wells Fargo stated that dealers should expressly be permitted to include on customer confirmations explanatory language to help investors understand the disclosed mark-up or mark-down. In addition, Fidelity, SIFMA and BDA stated that firms should be permitted to label the disclosed mark-up or mark-down as "estimated" or "approximate," because the mark-up or mark-down is not a standardized calculation. Similarly, Wells Fargo suggested the use of such qualifiers because a mark-up or mark-down is not always pure profit to the firm, and Wells Fargo stated this should be clarified to investors.

The MSRB disagrees that dealers expressly should be permitted to label the disclosures "estimated" or "approximate," as such labels have the potential unduly to suggest an unreliability of the disclosures or otherwise diminish their value. However, the MSRB agrees that firms should be permitted to include explanatory language or disclosures on confirmations to provide context and understanding for investors receiving mark-up and mark-down disclosures, such as an explanation of how the disclosure was derived. As long as such explanatory language is

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17 In contrast, if a dealer systematically inputs the mark-up related information into its systems at the end of the day for the generation of confirmations, under the same trading scenario described above, the dealer must consider any subsequent contemporaneous proceeds that occurred after the time of trade but before the end of the day, for both disclosure and fair-pricing purposes.

accurate and not misleading, the MSRB believes dealers should have the flexibility to determine how to craft such language for their customers.

Policies and Procedures; Similar Securities. Several commenters requested confirmation or clarification that firms may adopt reasonable policies and procedures regarding the implementation of particular aspects of the guidance. SIFMA stated that the MSRB should clarify that firms may adopt, as an alternative to contemporaneous cost or proceeds, a variety of other reasonable methodologies to automate the determination of prevailing market price for disclosure purposes. SIFMA also requested confirmation that firms may adopt reasonable policies and procedures with respect to imputed mark-ups or mark-downs in contemporaneous customer transactions. SIFMA and BDA both sought acknowledgement from the MSRB that different firms may reach different conclusions as to whether securities are similar and sought confirmation that firms may adopt reasonable policies and procedures to make that determination.

Under Rule G-30, dealers must establish market value as accurately as possible using reasonable diligence under the facts and circumstances.[18] Consistent with this longstanding standard of reasonable diligence, the MSRB stated in the filing supporting the proposed rule change that the MSRB expects that dealers will have reasonable policies and procedures in place to determine the prevailing market price and that such policies and procedures are applied consistently across customers. That statement, however, means that the MSRB expects such policies and procedures to be designed to implement the prevailing market price guidance, not to create an alternative manner of determining prevailing market price. The MSRB also expects that such policies and procedures will be reasonably designed to implement all applicable components of the prevailing market price determination. Thus, for example, as described in the filing, dealers should establish policies and procedures pertaining to the provisions regarding functionally separate trading desks, if applicable. Similarly, as applicable, firms should establish reasonable policies and procedures relating to, without limitation, inter-affiliate transactions, the determination of imputed mark-ups and mark-downs, the determination of similar securities, and the use of economic models. The MSRB expects that all such policies and procedures will be consistent with the prevailing market price guidance and all related interpretive or explanatory statements in the filing supporting the proposed rule change and will be consistently applied.[19]

Additionally, the MSRB believes that it may be reasonable for a dealer that chooses largely to automate the prevailing market price determination to establish in its policies and procedures objective criteria reasonably designed to implement aspects of the waterfall that are not prescribed and as to which dealers would have discretion to exercise a degree of subjectivity if the determination were not automated. For example, in determining a firm's contemporaneous cost in connection with a sale to a customer, if the firm has multiple contemporaneous purchases from a customer, the firm could provide in its policies and procedures that it will consistently apply a "last in, last out" approach in determining its contemporaneous cost in such situations.

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18 See Rule G-30, Supplementary Material .04(b).

19 See, e.g., 81 FR at 62954.

Similarly, a dealer may determine to use objective criteria in connection with programming other unprescribed aspects of the guidance.

Finally, with respect to similar securities, the MSRB agrees that different firms may reasonably reach different conclusions as to whether securities are similar. As explained in the filing supporting the proposed rule change, for a security to qualify as sufficiently similar to the subject security, the security must be at least highly similar to the subject security with respect to nearly all of the listed similar security factors that are relevant to the subject security at issue. The MSRB reaffirms, in response to the comments, that firms may adopt reasonable policies and procedures to implement this guidance. Again, the MSRB expects that they are then consistently applied.

Effective Date. Many commenters requested a longer implementation period as well as harmonized implementation dates between the MSRB and FINRA. Commenters were concerned that the one-year implementation time period proposed by the MSRB underestimated the substantial operational cost and complexity of implementing the proposed rule change. Commenters also urged the MSRB to consider the limited technology and operational resources available to firms due to other major regulatory changes that they expect to be implementing during the same time period. The SEC Investor Advocate recommended a one-year implementation period, although it recognized that technical systems changes would be required to comply with the proposed rule change.

In response to the comments, the MSRB, in Amendment No. 1, is extending the implementation time to provide that the effective date of the proposed rule change, if approved, will be no later than eighteen months following Commission approval. The MSRB believes that this lengthening of the implementation period will mitigate the costs of implementation.

Economic Analysis. BDA, Fidelity, FIF, RW Smith and SIFMA expressed concern regarding the overall cost of the proposed rule change. FIF and SIFMA suggested the cost of implementing the proposed rule change may outweigh any benefits that might be gained. FIF and RW Smith indicated that the heaviest costs and burdens will fall on smaller firms, while RW Smith also suggested that the need for enhanced transparency could be addressed more economically and reasonably through the EMMA platform. RW Smith also commented that an unintended consequence of the proposed rule change is that the need to pay for such efforts will lead firms to reduce head count or exit the industry. RW Smith, SIFMA and Wells Fargo suggested that instead of the proposed rule change, the MSRB should focus on enhancing its existing technology platform, EMMA, to achieve the desired transparency. FIF questioned whether the SEC, MSRB or FINRA conducted a cost/benefit analysis of the proposed rule change and noted that while the MSRB's filing indicated that cost estimates were not provided by the industry in response to the request for comment, FIF provided preliminary information on the implementation cost of the proposal in a prior comment letter.[20] SIFMA noted its view that

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20 The majority of FIF's comment letter was devoted to its view that the determination of mark-ups/mark-downs should be derived from the prevailing market price "in all

there was no indication that the MSRB measured or fully considered the risk that its proposal will impair liquidity in the municipal market. SIFMA stated that "even a small reduction in retail bond market liquidity could easily injure investors far more seriously than any benefit to be gained" by the proposed rule change. SIFMA urged the MSRB to conduct a "more thorough analysis" of the proposed rule's impact on liquidity. SIFMA further urged the MSRB to conduct data analysis that considers the differences between firms that carry inventory and firms that do not.

The MSRB believes that retail investors are currently limited in their ability to assess and compare transaction costs associated with the purchase or sale of municipal securities. Results from a joint investor study, reviewed by the MSRB and FINRA, support the MSRB's belief that investors lack a clear understanding of how dealers are compensated when dealers act in a principal capacity and that investors have a desire for more information on this topic. In addition, mark-up and mark-down disclosure may improve investor confidence, better enable customers to evaluate the costs and quality of the execution service that dealers provide, promote transparency into dealers' pricing practices, improve communication between dealers and their customers, and make the enforcement of Rule G-30 more efficient. The MSRB also believes that the prevailing market price guidance would promote consistent compliance by dealers with their existing fair-pricing obligations under MSRB rules and would support effective compliance with the proposed amendments to Rule G-15.

At the same time, the MSRB recognizes that the proposed rule change would impose burdens and costs on dealers. As noted in the filing supporting the proposed rule change, the MSRB has received comments indicating that the MSRB's proposals included in the relevant requests for comment would impose significant implementation costs on dealers. For example, the MSRB recognized that the proposed rule change would require dealers to develop and deploy a methodology to satisfy the disclosure requirement, identify trades subject to the disclosure (unless dealers voluntarily disclose on all principal trades with non-institutional customers), convey the mark-up on the confirmation, determine the prevailing market price and the mark-up and adopt policies and procedures to track and ensure compliance with the requirement. The MSRB has received an estimate of one cost element from FIF, an organization whose participants include trading and back office service bureaus, broker-dealers, market data vendors and exchanges—setting forth a $500,000 estimate to capture contemporaneous cost. FIF explained that this estimate does not include the cost that would be imposed on introducing brokers.

The MSRB continues to believe that the proposed rule change reflects the overall lowest cost approach to achieving the regulatory objective. As demonstrated through the multi-year rulemaking process on this subject, the MSRB has evaluated reasonable regulatory alternatives and has made several changes to make implementation less costly and burdensome. Moreover,

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instances." The MSRB believes that the requirements of the proposed rule change are consistent with this request.

the amendments included in Amendment No. 1 and the additional clarifications of the proposed rule change provided here may also make the proposed rule change less costly and burdensome.

Miscellaneous. BDA requested clarification regarding the use of isolated transactions under the guidance. BDA noted that while the rule text in the proposed rule change provides that a dealer "may" give isolated transactions little consideration in their analysis, the descriptive language in the MSRB's filing suggested a more restrictive approach to the use of isolated transactions.

The MSRB notes that the descriptive language included in the filing paraphrased the rule text, and the actual rule text controls. To clarify, a dealer may give little or no weight to pricing information resulting from an isolated transaction; the weight (if any) given to such a transaction is dependent on the facts and circumstances surrounding the transaction.

Thomson indicated that some smaller institutions may not meet the institutional account definition even though they trade via DVP/RVP accounts and rely on institutional confirmation processes. Thomson noted that sometimes these firms receive confirmations outside of the ID process and thus asked the MSRB to clarify that no modifications to the DTCC ID system are required by the proposed rule change. In the alternative, the commenter asked that the MSRB exempt DVP/RVP accounts from the proposed rule change, stating the view that this would be consistent with the MSRB's focus on enhanced disclosure to retail investors.

The MSRB continues to believe that investors that do not meet the "institutional account" definition—a standard used in other MSRB rules and that is consistent with the standard set forth by FINRA in its mark-up disclosure proposal—should gain the benefits and protections of the proposed disclosures. As a result, the MSRB does not believe that exempting certain classes of "non-institutional investors" from receiving the proposed disclosures is desirable or consistent with the intended goals of the proposed rule change.

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If you have any questions, please feel free to contact me, Margaret Blake, Associate General Counsel, or Saliha Olgun, Assistant General Counsel, at 202-838-1500.

Sincerely,

Michael L. Post
General Counsel – Regulatory Affairs