

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-47650; File No. SR-MSRB-2003-02)

April 8, 2003

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Proposed Rule Change Relating to Rule G-14, on Reports of Sales or Purchases

Pursuant to Section 19(b)(1) of the Securities and Exchange Act of 1934 (the “Exchange Act”) and Rule 19b-4 thereunder,¹ notice is hereby given that on April 7, 2003, the Municipal Securities Rulemaking Board (“MSRB”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change (File No. SR-MSRB-2003-02) (the “proposed rule change”) described in Items I, II, and III below, which Items have been prepared by the MSRB. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION’S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

The MSRB has filed with the Commission a proposed rule change with regard to Rule G-14, on reports of sales or purchases, to increase transparency in the municipal securities market. The proposed rule change would not change the wording of Rule G-14.

II. SELF-REGULATORY ORGANIZATION’S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, the MSRB included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at

¹ 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4 thereunder.

the places specified in Item IV below. The MSRB has prepared summaries, set forth in Section A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the proposed rule change is to increase price transparency for municipal securities by increasing the amount of price data available on the day after trade date.

Background Information

Since the implementation of the inter-dealer trade reporting system in 1995, the MSRB has been increasing price transparency in the municipal securities market in measured steps.² The first price transparency report was a T+1 report that summarized high, low and average inter-dealer prices for issues that met a trading threshold of four or more trades in the inter-dealer market. In 1998, the MSRB implemented the customer transaction reporting system and customer transaction data was added to the T+1 summary report. The trading threshold of four trades was retained, but since it applied regardless of whether the trades were inter-dealer or customer, many more issues met the trading threshold and were subject to price reporting. In January 2000, the MSRB further enhanced the T+1 report by publishing individual transaction data (rather than high, low and average prices) for each issue contained in the report.

In October 2000 the MSRB began offering a comprehensive transaction report,

² This plan has been discussed in many notices since 1994. See, e.g., "Board to Proceed with Pilot Program to Disseminate Inter-Dealer Transaction Information," MSRB Reports, Vol. 14, No. 1 (January 1994).

which lists all municipal securities transactions (regardless of frequency of trading) and includes late-reported trades, inter-dealer trades compared after trade date, and transaction data corrected by dealers after trade date. The Comprehensive Report began with a minimum one-month delay in trade publication. That delay has gradually been reduced such that the report currently is disseminated on a daily basis, one week after trade date. To make more trade data available on a T+1 basis, in 2002, the MSRB began the process of lowering the trading threshold in the T+1 Daily Report. In May 2002, the MSRB changed the trading threshold to three trades.³ In November 2002, the trading threshold was lowered to two trades.⁴

The T+1 Daily Report and the Comprehensive Report have been well received by market professionals seeking information on market price levels and trading activity for individual securities.⁵ The reports have garnered greater and greater use over time, both with market professionals and through free, customer-oriented outlets such as “InvestingInBonds.com” operated by The Bond Market Association (“TBMA”). At this time, in preparation for the move to real-time price transparency in mid-2004, the MSRB believes that the trading threshold in the T+1 Daily Reports should be eliminated to further increase the price transparency that is available on T+1.

Proposed Changes in the T+1 Daily Report

The MSRB has noted since the outset of its transparency initiative that, as the

³ See Release No. 34-45861 (May 1, 2002), 67 FR 30989.

⁴ See Release No. 34-46819 (November 12, 2002), 67 FR 69779.

⁵ Currently, the MSRB has twenty-four subscribers to the T+1 Daily Report and fifty-one to Comprehensive Report.

market obtains experience with price transparency, price reports eventually would need to occur on a more contemporaneous and comprehensive basis, culminating with real-time transaction reporting.⁶ The proposal to change the T+1 Daily Report at this time is part of the MSRB's longstanding plan to introduce transparency in measured steps, allowing the market time to adjust to new situations presented by each new level of price transparency. As an example, when price reports were first introduced in 1995, the MSRB was concerned that an observer might be misled if he or she considered an isolated transaction or pair of transactions as providing the same indicator of "market price" as a stock exchange quotation. The MSRB believes that, considering the unique nature of the municipal securities market, the market has adapted very well to price transparency. The MSRB is not aware of any problems occurring similar to the concerns expressed in 1995. The reception of the Comprehensive Report and the previous lowering of trading thresholds on the T+1 Daily Report has been positive and the use of the data in those reports by market professionals and pricing services has increased the efficiency and accuracy with which issues are priced in the secondary market.

The proposed rule change would increase substantially the number of trades and issues appearing each day on the T+1 Daily Report. On a typical trading day, dealers report approximately 26,000 transactions in 10,000 issues, with a total par value traded of about \$9.5 billion.⁷ The present T+1 Daily Report, with a trading threshold of two or more trades per day, includes an average of 19,760 trades in 5,600 issues, with a total par

⁶ See, e.g., "Board to Proceed with Pilot Program to Disseminate Inter-Dealer Transaction Information," MSRB Reports, Vol. 14, No. 1 (January 1994).

⁷ This baseline data is based upon market activity from April 1, 2001 through July 31, 2001.

value of about \$7.7 billion. Currently, only about 76% of transactions reported on trade date are shown on the report. Under the proposed rule change, all trades reported by dealers on trade date would be made visible on T+1.

Although the MSRB believes it is appropriate to increase T+1 transparency at this time, and to move forward with its plans for real-time trade reporting in mid-2004, the MSRB also is mindful of concerns expressed by dealers that further increases in transparency on a more contemporaneous basis could have an effect on liquidity. One concern sometimes noted is that because of the nature of the municipal securities market, including the prevalence of thinly traded issues, it sometimes is possible to identify institutional investors and dealers by the exact par value given on trade reports. For example, it might be common market knowledge that a \$4.25 million position in an issue initially was purchased in the primary market by a specific institution. Trade reports in the secondary market showing this exact par value later being sold then could reveal the identity of that party as well as the price received. Where the market for a specific security is thin and only one or two dealers are active, revealing the exact par amount also may convey information about a dealer's inventory (i.e., size of position and acquisition cost). Other dealers may use this information to trade against the dealer's position, reducing the incentive for a dealer to take large positions in these circumstances.

In response to these concerns, the MSRB proposes to take a step similar to that used by the NASD's "TRACE" system in the corporate bond market and to display par value of large trades with a large trade indicator rather than the exact par value.⁸ While

⁸ See NASD Notice to Members 01-18, "Fixed Income Transaction Reporting and Dissemination," March 2001.

this will result in less information being made visible on T+1 about par value traded, the MSRB believes that it will help to preserve the anonymity of trading parties and will not detract in a substantial way from the benefits of the price transparency it provides.

The enhanced Daily Report with the frequently traded threshold removed would replace the current T+1 Daily Report and would be made available each day to subscribers via the Internet. Subscribers to the current Service receive the report free of charge, and their subscriptions would continue. New subscriptions would continue to be available free to parties who sign a subscription agreement. In addition, recent reports would continue to be available for examination, also free of charge, at the MSRB's Public Access Facility in Alexandria, VA.

The MSRB will continue to produce its Comprehensive Report on a one-week delay basis with details about all transactions traded one-week prior. The Comprehensive Report will continue to provide information on the size of each transaction including the exact par amount reported to the MSRB on transactions in amounts greater than one million dollars. The Comprehensive Report also will continue to be useful since it will include details of transactions reported to the MSRB late, inter-dealer trades compared after trade date, and any transaction data corrected by dealers after trade date.

Implementation Schedule

The enhanced report would be available to subscribers as soon as practical after Commission approval of the proposed rule change. It is estimated that the period between approval and implementation would not exceed four weeks.

2. Basis

The MSRB has adopted the proposed rule change pursuant to Section 15B(b)(2)(I) of the Exchange Act, which authorizes the MSRB to adopt rules that provide for the operation and administration of the Board.

B. Self-regulatory Organization's Statement on Burden on Competition

The MSRB does not believe that the proposed rule change will impose any burden on competition in that it applies equally to all dealers in municipal securities.

C. Self-Regulatory Organization's Statement of Comments on the Proposed Rule Change Received from Member, Participants, or Others

Written comments on the proposed rule change were not solicited, but the MSRB had earlier received a copy of a comment letter from TBMA to the Commission in reference to proposed rule change SR-MSRB-2002-07 regarding shortening the delay in publication of the Comprehensive Report from two weeks after trade date to a one-week delay.⁹ In its letter, the TBMA expressed its continued support for the MSRB's steps to expand transparency in the municipal securities market. TBMA also stated a concern that price dissemination on a next-day basis for all issues that trade only once per day would not necessarily provide useful information to investors and other market participants or could adversely affect liquidity or might be misleading.

As noted above, the final reduction of the T+1 trading threshold is part of a long-term plan for measured increases in transparency. The Board believes that prior experience with the program indicates both that the additional information provided by the proposed rule change will be useful and will not be misconstrued by users of the data, who now have experience with the price information and know how to interpret it.

⁹ See letter from Frank Chin, Chair, Municipal Executive Committee, TBMA, to Jonathan G. Katz, Secretary, Commission, dated August 8, 2002.

As noted above, the MSRB also has considered the concerns expressed by the TBMA that further increases in transparency on a more contemporaneous basis could have an effect on liquidity. The MSRB believes that the proposal to display par value of transactions over one million dollars with a large trade indicator rather than exact par value will ameliorate these concerns.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the forgoing. Persons making written submission should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submissions, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing will also

be available for inspection and copying at the MSRB's principal offices. All submissions should refer to File No. SR-MSRB-2002-14 and should be submitted by [insert date 21 days from the date of publication].

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland
Deputy Secretary

¹⁰ 17 CFR 200.30-3(a)(12).