Recommendation of the Investor Advisory Committee To Enhance Information for Bond Market Investors (June 7, 2016)

Recommendations:

1. The Committee recommends that the Commission actively engage with the Municipal Securities Rulemaking Board ("MSRB") and the Financial Industry Regulatory Authority ("FINRA") to finalize their proposals to require dealers to provide more information to retail investors so that they can see the full transaction costs of purchasing or selling a bond, not only commissions[1] or fees when a dealer acts as agent, but also markups or markdowns when a dealer is acting as a principal. With this recommendation, the Committee does not take the position that markups/markdowns in the bond market are too large; the Committee also notes that the recently implemented best execution rule for municipal bonds, together with long-standing rules covering corporate and agency bonds, have enhanced protection to investors in this regard. However, the Committee believes more information about the full transaction cost of purchasing or selling a bond, even if provided after the investment decision, will benefit investors.

2. Longer term, the Commission should work with brokers, FINRA, and the MSRB to get full transaction cost information to investors before they purchase or sell a bond. Most retail investors do not trade bonds on a regular basis, and they do not have a lot of experience on which to judge a proposal from their broker. Furthermore, substantial advancements in information technology have dramatically reduced the cost of providing information to investors, while greatly increasing the speed of providing this information. Brokers already provide investors the price and the yield for the bond before the investor decides to transact, so providing the all-in transaction cost should be feasible. Providing comprehensive information that is material to the investment decision, including price, yield, and transaction costs, prior to the investment decision is likely to have the biggest impact in terms of promoting competition and fair dealing.

3. We encourage the Commission to work with the MSRB and FINRA to continue to improve easy access to price transparency in bond markets for retail investors. Investors should be able to easily find information on the prices and yields of recent transactions in municipal, agency, and corporate bonds. Websites sponsored by the MSRB and FINRA have improved access to recent transaction data, especially the Electronic Municipal Market Access ("EMMA"), but are still cumbersome for retail investors to navigate, especially if they are not regular users. Investors would also benefit from being able to research current bids and offers for various bonds to get a better sense of the market. The MSRB discussed a "Central Transaction Portal" several years ago, which would aggregate and publically display current bids and offers from all the brokers, but no further action has occurred. Access to this kind of information will help inform their investment decisions when they are considering purchasing or selling those or similar securities.

[1] MSRB: "Under MSRB Rule G- 15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers, dealers are required to disclose on the customer confirmation transaction-based remuneration received from the customer when the dealer acts as agent. There is, however, currently no comparable disclosure requirement under SEC or MSRB rules when the dealer acts as principal."

Background:

The fixed income markets in the U.S. are substantially larger than the equity markets. As the Wall Street Journal noted in October 2015, "[t]he U.S. bond market is among the biggest financial markets in the world, with $39.5 trillion outstanding at mid-2015…That is equivalent to 1½ U.S. stock markets and nearly twice the aggregate size of the five largest foreign stock exchanges (in Japan, China and Europe) …"

Enhanced disclosure and transparency for investors in municipal, corporate, and agency bonds have long been a priority for the Commission. In 2012, the Commission issued a Report on the Municipal Securities Market (Report on the Municipal Securities Market), and more recently Chair White discussed these issues in her June 2014 speech (Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors). One of Chair White's conclusions was "that in the fixed income markets, technology is being leveraged simply to make the old, decentralized method of trading more efficient for market intermediaries, and its potential to achieve more widespread benefits for investors, including the broad availability of pre-trade pricing information, lower search costs, and greater price competition – especially for retail investors – is not being realized."

At the Commission's urging, a Best Execution rule has been enacted for municipal bonds (paralleling the one for agencies and corporates issued several years before), and both FINRA and MSRB recently provided interpretive guidance to enhance compliance, which went into effect in March 2016. But two other critical efforts in enhanced cost disclosure and price transparency have not been completed.

1. **Enhanced disclosure of full transaction costs**

The Committee believes it is important to enhance disclosure, especially for retail investors, about the markup/markdown that an investor pays when purchasing/selling a bond in the secondary market from a dealer acting as a principal. (Given the OTC nature of the bond market, many retail investor purchases are made by dealers selling from their inventory of recently purchased bonds.)

This is an issue that has been discussed for years, and the Committee heard from speakers at a recent meeting. Last year each of the MSRB and FINRA issued proposals and earlier this year indicated a growing convergence in approaches.[2] The MSRB proposal would require disclosing the price that the

[2] FINRA: "[T]he MSRB also published a notice soliciting comment on a revised proposal. As described in detail in the MSRB's notice, the MSRB's approach differs from FINRA's proposed approach described above and would require disclosure of the amount of the firm's mark-up (or mark-down) for certain retail customer transactions, rather than the reference price paid by the firm and the differential between the reference price and the price paid by the customer. Under the MSRB's proposal, the firm would be required to disclose its mark-up or mark-down from the prevailing market price of a security if the firm traded as principal with a non-institutional customer within a discrete time window (*e.g.*, the firm purchased the security in the two hours preceding the sale to the customer, or sold the security in the two hours following the purchase from the customer). While FINRA and the MSRB's revised proposals currently differ, both entities favor a coordinated approach. Accordingly, FINRA is

dealer paid, if it acquired the security near in time to the resale, so an investor could see the markup/markdown. There has been a lot of industry and advocate commentary, and FINRA revised its proposal last fall and discussed it again in February 2016, when it indicated that it was considering moving to harmonize with the MSRB approach. The Committee believes that active engagement by the Commission could encourage the marketplace to move more expeditiously to complete rules and implement these important improvements in transparency.

MSRB and FINRA Pricing Disclosure Rules

a. MSRB Proposed Mark-Up Disclosure (Sept. 24, 2015)

b. Comment Letters to MSRB Proposal

c. FINRA Revised Price Reference Disclosure (Oct. 2015)

d. Comment Letters to FINRA Proposal

2. Enhancing access to material information prior to the investment decision

The second area of focus is increasing the public's access to information about current price, yield, and transaction costs prior to their making an investment decision. Compared to the amount of data available for even less liquid equities, mutual funds, and ETFs, bond data is hard to find and hard to use once it is found. The Committee encourages the Commission to redouble its efforts to make relevant transaction data (pre- and post-trade) more readily available to investors to better inform their investment decisions.

Comparing prices among dealers for similar bonds, or even just getting general yield levels from recent transactions that reflect current market conditions, are both quite difficult for most bond investors. Enhanced transparency could help all investors and other market participants, but will be of particular use to retail investors who transact infrequently in the bonds markets, and therefore would not typically have recent transaction information of their own to use in their investment decisions.

There are two types of information that would be helpful to retail investors:

-post-trade information on recent, relevant transactions and

-pre-trade bids and offers from multiple brokers.

The upgraded the EMMA system managed by the MSRB (http://emma.msrb.org/) provides more information about recent municipal bond transactions than used to be available, but it is still difficult to navigate, and the EMMA data is not readily available on major news or consumer financial websites. TRACE, for corporate and agency bonds, provides only prior day data on a short list of active corporate bonds, and while there is more data on agency bonds, it is more likely to be useful to professional

inviting comments on the MSRB's proposal in comparison to FINRA's revised proposal, and whether the MSRB's proposal, or elements of the proposal, may be an appropriate alternative to FINRA's revised proposal."

advisors than retail customers. Investors who have an account with an online brokerage firm can access that firm's bids/offers, but has little information to use to see if those prices are competitive.

Both the MSRB and FINRA have put out some preliminary ideas on how dealers could provide more data to the investing public, but there is no clear consensus on how to proceed, and progress seems stalled. The MSRB concept release (from 2013) discusses the development of a "Central Transparency Platform" that would show actual current bids and offers from multiple brokers to the public. The more recent FINRA proposal would only provide data to regulators, not the public.

Transparency

a. MSRB Concept Release on Pre-Trade and Post-Trade Pricing Data Dissemination Through a New Central Transparency Platform (Jul. 31, 2013)

b. FINRA Requests Comment on Proposal to Require Alternative Trading Systems to Submit Quotation Information Relating to Fixed Income Securities (Feb. 2015)