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March 31, 2016

By Electronic Mail

Re: Municipal Securities Rulemaking Board Request for Comment on Draft Amendments to MSRB Rule G-30 to Provide Guidance on Prevailing Market Price, Feb. 18, 2016

Mr. Ronald W. Smith
Corporate Secretary
Municipal Securities
Rulemaking Board
1300 I Street NW, Suite 1000
Washington, DC 20005

Dear Mr. Smith,

Markit appreciates the opportunity to comment on the Municipal Securities Rulemaking Board ("MSRB" or "Board")'s Request for Comment on Draft Amendments to MSRB Rule G-30 to Provide Guidance on Prevailing Market Price ("RFC").[1]

I. About Markit

Markit[2] is a leading global diversified provider of financial information services. Founded in 2003, we employ over 4,000 people in 11 countries, including over 1,600 in the U.S., and our shares are listed on Nasdaq (ticker: MRKT). Markit's products and services enhance transparency, reduce risk and improve operational efficiency of financial market activities. Our customers include banks, hedge funds, asset managers, central banks, regulators, auditors, fund administrators and insurance companies. By setting common standards and facilitating market participants' compliance with various regulatory requirements, many of our services help level the playing field between small and large firms and foster a competitive marketplace.

Markit has been actively and constructively engaged in the debate about regulatory reform in financial markets, including topics such as the implementation of G20 commitments for OTC derivatives and the design of a regulatory regime for benchmarks. Over the past years, we have submitted more than 140 comment letters to regulatory authorities around the world and have participated in numerous roundtables.

Markit Pricing Data for bonds provides broker-dealers, buyside firms, and other market participants independent pricing, transparency and liquidity data on bonds across the universe of corporate and sovereign securities, municipal bonds as well as European and US securitized products. Markit's bond data uses price inputs from a variety of sources that are either aggregated to calculate composite levels or fed into a dynamic model to produce a price

[1] Request for Comment on Draft Amendments to MSRB Rule G-30 to Provide Guidance on Prevailing Market Price, Feb. 18, 2016, http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2016-07.ashx.
[2] See www.Markit.com for more details.

validated against a number of parameters. The service also includes full transparency on the depth of price sources used, a liquidity score reflecting the frequency and breadth of pricing and comprehensive analytics.

Markit Pricing Data provides comprehensive insight into the municipal bond market, delivering pricing and liquidity data for more than 1.1 million municipal bonds.[3] Data from our parsing technology and the MSRB's EMMA is fed directly into our pricing engine to support rapid updates to municipal bond prices. The pricing methodology also incorporates the financial condition of each state and municipality, uses of proceeds and other factors at the issue level to drive movements in price, regardless of the credit rating.

II. Executive summary

We recommend generally that the Board focus on ensuring that the "prevailing market price disclosure" reflect prices that exist in the *current market* for a municipal bond rather than a price that is developed as a function of a strict hierarchy of factors. For reasons described in further detail below, we recommend the Board:

- eliminate the step-based hierarchy in favor of an approach whereby all of the factors in the hierarchy could be considered if the firm has a reasonable basis to believe that considering all of the factors for a particular security and similar securities would lead to a more accurate prevailing market price;
- make its hierarchy of factors non-exclusive or amend it to include new factors, e.g., trade size, or provide a means for firms to consider other factors when the firm has a reasonable basis to believe that the additional factor would make the prevailing market price more accurate; and
- should work with the Financial Industry Regulatory Authority (FINRA) to ensure that it too updates its policy for debt securities under its oversight to harmonize with the prevailing market price guidance developed by the Board. This is particularly important for FINRA securities most similar to most municipal bonds, e.g., infrequently traded corporate debt securities.

Finally, we believe that the threat of a disclosure violation would ensure that firms use the most accurate methodology for determining a prevailing market price under the more flexible approach we have recommended.

III. Discussion

1. The Board should eliminate the step-based hierarchy in favor of an approach whereby all of the factors in the hierarchy could be considered if the firm has a reasonable basis to believe that considering all of the factors for a particular security and similar securities would lead to a more accurate prevailing market price

While a prevailing market price standard has been used historically to ensure fair and reasonable pricing to customers, under securities law broker-dealers have never been required to disclose a specific prevailing market price.[4] This new disclosure requirement has led many of

[3] See Municipal, https://www.markit.com/Product/Pricing-Data-Bonds-Municipal.
[4] We note that the disclosure of a specific prevailing market price in customer confirmations exposes firms to disclosure-related legal liability, e.g., Rule 10b-5.

our customers to rethink what a “prevailing market price” means precisely in the context of municipal (and corporate) bonds.

The RFC models its guidance on prevailing market prices based on existing FINRA guidance, finalized in 2007.[5] The below chart from the RFC summarizes the hierarchy of factors:

Overview of Draft Guidance

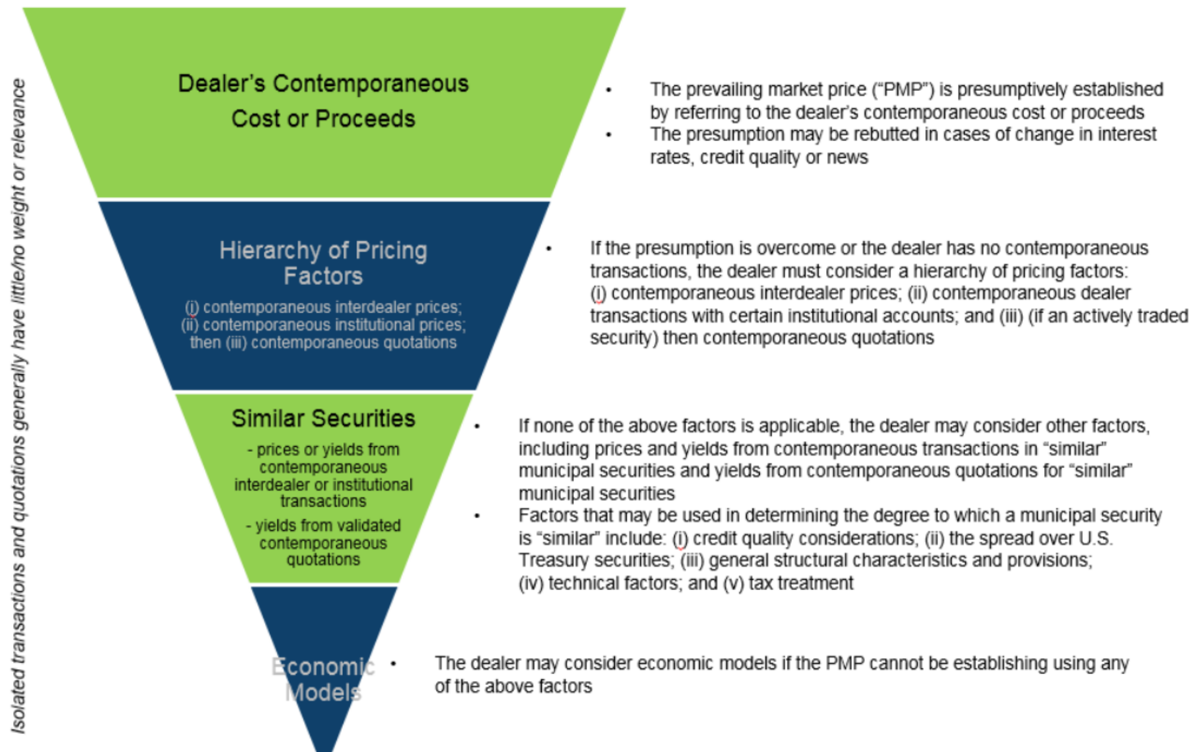

Figure 1

Importantly, a subsequent factor may be considered only if previous factors in the hierarchy are inapplicable. We call this approach a “step-based” hierarchy whereby a set of factors may only be considered if and only if factors in a previous step in the hierarchy are inapplicable.

We think that this In a 1984 Securities and Exchange Commission administrative proceeding involving *Alstead, Dempsey, and Co*., the SEC described the general principle underlying the concept of “prevailing market price.”[6] The SEC explained that “[t]he prevailing market price means the price at which dealers trade with one another, i.e., the current inter-dealer market.”[7] The SEC explained further:

> Where there is an active, independent market for a security, and the reliability of quoted offers can be tested by comparing them with actual interdealer transactions during the period in question, such quotations may provide a proper basis for computing markups. Thus, if inter-dealer sales occur with some frequency, and on the days when they occur they are consistently effected at prices at or around the quoted offers, it may properly be

[5] FINRA Rule 2121, including Supplementary Material .01, Mark-Up Policy, and Supplementary Material .02, Additional Mark-Up Policy for Transactions in Debt Securities, Except Municipal Securities Supplementary Material .02 (2007).
[6] *Alstead, Dempsey & Co.,* Exchange Act Release No. 34-20825, 47 S.E.C. 1034 (April 5, 1984).
[7] Id. at 1035.

inferred that on other days such offers provide an accurate indication of the prevailing market.[8]

We recommend the Board focus on prices that exist in the *current market* for a municipal bond rather than a strict hierarchy of factors. A step-based hierarchy can lead to misleading and inaccurate prevailing market price disclosures. For example, a given municipal bond may not have a “contemporaneous cost” (step one of the hierarchy) or have contemporaneous pricing factors (step two of the hierarchy) but there may be transactions in similar securities, but those transactions by themselves may not result in a prevailing market price disclosure that would be as accurate as one including the results of an economic model.[9]

Accurately determining the current price of a particular municipal security is what drives Markit’s (and other data vendors’) municipal bond pricing services and to do so, we do not limit our data set to particular factors when other factors are relevant. Certain factors may be weighed more heavily, of course, e.g., data relating to the particular municipal security, but other data lower in the RFC’s hierarchy may still relevant to determining price, as is size (see section 2 below).

We therefore recommend the Board either:

(1) eliminate the step-based hierarchy in favor of an approach whereby all of the factors in the hierarchy could be considered if the firm has a reasonable basis to believe that considering all of the factors for a particular security and similar securities would lead to a more accurate prevailing market price or

(2) provide a safe harbor for firms disclosing a prevailing market price for an infrequently traded municipal if they have a reasonable basis to believe that relying on all of the hierarchy factors for their municipal bond or similar securities would lead to a more accurate prevailing market price. The Commission could condition this allowance based on periodic back-testing to ensure that the prevailing market price methodology (or source) that they use tends to be more accurate than a strict application of the step-based hierarchy.

2. **The Board should make its hierarchy of factors non-exclusive or amend it to include new factors, e.g., trade size, or provide a means for firms to consider other factors when the firm has a reasonable basis to believe that the additional factor would make the prevailing market price more accurate**

The RFC does not include trade size as a factor to consider in determining the prevailing market price. Large trades, particularly for illiquid securities, are more likely to have greater price variation from the current market price. This is because such trades often include a larger liquidity premium, i.e. the cost or risk a market-maker would bear for offsetting the transaction in one or multiple trades is greater. The markets ability to absorb trades with minimal impact diminish as trade size increases, thus, large trades should therefore be interpreted and weighted in this light. On the other hand, small or odd-lot transactions may be more expensive for a customer because smaller or odd-lot trades incur the same fixed costs of trading as larger trades and therefore have fewer willing dealers to provide liquidity, resulting in higher prices (if the customer is buying) and vice-versa.

[8] Id.
[9] Under the RFC, firms may use economic models to determine a “prevailing market price,” taking into account factors such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value, and may consider all applicable pricing terms and conventions used.

The prevailing market price for a trade therefore varies based on the size of the trade. Accordingly, we recommend the Board allow firms to adjust the prevailing market price to the size of a trade in order to ensure that the comparison of the executed and prevailing market prices are done on "apples to apples" basis. The best approach the Board should take is to make the hierarchy of factors as non-exclusive when a firm has a reasonable basis to believe additional factors would make the prevailing market price disclosure more accurate. While we think this more flexible approach is more likely to produce more accurate prevailing market price disclosures, an alternative to consider is one whereby trade size becomes a factor included in the hierarchy. We think it should be a part of the first three steps of the hierarchy in this case.

3. **The Board should work with the Financial Industry Regulatory Authority (FINRA) to ensure that it too updates its policy for debt securities under its oversight to harmonize with the prevailing market price guidance developed by the Board. This is particularly important for FINRA securities most similar to most municipal bonds, e.g., infrequently traded corporate debt securities**

We believe that the Board will likely have to differentiate its approach to prevailing market price from that used by FINRA in FINRA Rule 2121. We make this suggestion because, most importantly, (1) FINRA didn't develop its rules to result in a specific prevailing market price disclosure and (2) the idiosyncratic characteristics of the municipal bond markets will likely yield a focus at the Board in 2016 different than the approach taken by FINRA some ten+ years ago. We think that the policy the Board develops for municipal bonds will lead to guidance that will improve FINRA's guidance, particularly for those FINRA securities most similar to municipal bonds, e.g., infrequently-traded securities. Accordingly, we recommend the Board work with FINRA to develop a modernized and harmonized approach to prevailing market prices.

4. **The threat of a disclosure violation would ensure that firms use the most accurate methodology for determining a prevailing market price under the more flexible approach we have recommended**

We understand the Board's use of a step-based and exclusive hierarchy of factors may be based on a desire to reduce the risk of opportunistic, false, or misleading prevailing market price disclosures. This risk is low, we think, because of the risks associated with such a disclosure in the form of legal liability that would attach from a false or misleading prevailing market price disclosure. This risk, we think, would incentivize firms to produce accurate prevailing market price disclosures and the flexible approach we've recommended above would give firms the tools they need to determine more accurate prevailing market price disclosures.

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Markit appreciates the opportunity to provide these comments to the Board. We would be happy to elaborate on or further discuss any of the points addressed above. If you have any questions, please do not hesitate to contact the undersigned or Salman Banaei at salman.banaei@markit.com.

Yours sincerely,

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