

# Resource on Disclosing Mark-ups and Determining Prevailing Market Price

The Municipal Securities Rulemaking Board (MSRB) is providing this compliance resource to assist brokers, dealers and municipal securities dealers (collectively, “dealers”) in their compliance with amendments to MSRB [Rule G-15](#) and [Rule G-30](#), effective as of May 14, 2018. The content of this document is derived from the relevant rulemaking record, MSRB rules and existing interpretive guidance, and is summarized and presented below in a format designed to facilitate dealer compliance. This resource should be read in conjunction with the relevant rules and related guidance, including frequently asked questions (FAQs).<sup>1</sup> This document does not create new legal or regulatory requirements, or new interpretations of existing requirements.

## OVERVIEW

Effective May 14, 2018, amendments to Rule G-15 and Rule G-30 generally require dealers to disclose additional information on certain retail customer confirmations, including the amount of the mark-up or mark-down charged (specified as a total dollar amount and as a percentage of the prevailing market price) on the transaction.<sup>2</sup> The amendments also establish new guidance to facilitate the determination of prevailing market price (PMP) for fair pricing purposes and to aid in the dealer’s determination of the amount of mark-up charged. Together, these requirements are designed to enhance transparency for retail investors as to the costs of their transactions in municipal securities and to provide them with valuable access to pricing and related information about their municipal securities.

The MSRB is making this compliance resource available to dealers to assist them in their efforts to comply with the amendments to Rule G-15 and Rule G-30. Dealers may wish to use this resource to support their continuing compliance efforts and in assessments of their relevant policies and procedures.<sup>3</sup> This compliance resource summarizes the amendments to Rule G-15 and Rule G-30 and relevant aspects of certain other key MSRB obligations. It also offers considerations designed to assist dealers with continued compliance.

## SUMMARY OF RELEVANT RULE REQUIREMENTS

### Summary of Amendments to Rule G-15 and Rule G-30

#### **Rule G-15: Mark-up Disclosure**

Dealers must disclose the mark-up on a municipal securities transaction with a non-institutional (*i.e.*, retail) customer if:

- The dealer also executes one or more offsetting principal transaction(s);
- On the same trading day as the customer transaction; and
- In an aggregate trading size that meets or exceeds the size of the customer trade.

A non-institutional customer is a customer that is not:

- A bank, savings and loan association, insurance company or registered investment company;
- An SEC- or state-registered investment adviser; or
- Any other entity (including a natural person) with total assets of at least \$50 million.

<sup>1</sup> See e.g., [MSRB Notice 2018-05, MSRB Provides New and Updated FAQs on Confirmation Disclosure and Prevailing Market Price](#) (March 19, 2018) (hereinafter referred to as “FAQ”).

<sup>2</sup> This document refers to mark-ups and mark-downs collectively as mark-ups, unless the context requires otherwise.

<sup>3</sup> This dealer compliance resource is not to be interpreted by dealers or examining authorities as establishing new standards of conduct. In conducting examinations of municipal securities transactions, examining authorities may conduct broader or narrower examinations, which may result in consideration of some or all of the content described in this resource.

The mark-up that is disclosed on the confirmation must be determined from the PMP of the security, in accordance with Rule G-30, Supplementary Material (SM) .06. For a summary of Rule G-30, SM .06, see the section titled “Rule G-30: Determination of the Prevailing Market Price” below.

There are three exceptions and one modification to the mark-up disclosure requirement.

**Exceptions.** Mark-up disclosure is not required:

- For transactions in municipal fund securities (e.g., 529 savings plans);
- For transactions that are list offering price transactions, as defined in paragraph (d)(vii)(A) of [MSRB Rule G-14](#) RTRS Procedures (generally primary market sale transactions executed on the first day of trading of a new issue by certain dealers at the published list offering price); or
- If the dealer executes an offsetting principal trade on a trading desk that is functionally separate from the trading desk that executed the customer trade, provided that the dealer maintains policies and procedures reasonably designed to ensure that the functionally separate trading desk had no knowledge of the customer trades.

**Modification.** If the dealer’s offsetting principal trade is executed with a dealer affiliate and did not occur at arm’s length, the dealer is required to “look through” to the time and terms of the affiliate’s trade with a third party to determine whether mark-up disclosure is required. An arm’s-length transaction is one conducted through a competitive process in which the non-affiliate firms could also participate, and where the affiliate relationship did not influence the price paid or proceeds received by the dealer.

### **Rule G-15: Time of Execution Disclosure**

Dealers must disclose the time of execution for all transactions, including principal and agency transactions. However, for transactions in municipal fund securities and transactions for institutional customers, rather than disclosing the time of execution, dealers instead may include on the confirmation a statement that the time of execution will be furnished upon written request. The disclosed time of execution should be the same as the time of trade for [Rule G-8](#) and Rule G-14 purposes and may be disclosed in either military time or in eastern time with an AM or PM indicator. Additionally, the disclosure either may omit the seconds or disclose the seconds (in either case, without rounding to the minute). The disclosure must be on the front of the confirmation.

### **Rule G-15: Link to Security-Specific Page on EMMA**

Dealers must disclose a security-specific URL on all non-institutional confirmations other than transactions in municipal fund securities, even where mark-up disclosure is not required. The template for the URL is [https://emma.msrb.org/cusip/\[insert CUSIP number\]](https://emma.msrb.org/cusip/[insert CUSIP number]). Dealers may omit the “s” in https. Paper confirmations must include the URL on the front of the confirmation in print form. Electronic confirmations must include the URL as a hyperlink. Regardless of whether the confirmation is paper or electronic, the URL must be accompanied by a brief description of the type of information that is available on the security-specific web page. An example of language that would meet this obligation is below:

“For more information about this security (including the official statement and trade and price history), visit [insert URL].”

Because the above language is an example only, dealers may opt to use different language to satisfy this requirement.

### **Rule G-30: Determination of the Prevailing Market Price**

Dealers must use reasonable diligence to determine the PMP of a security consistent with Rule G-30 and SM .06. Under the standard of reasonable diligence, dealers may rely on reasonable policies and procedures to facilitate PMP determination, as long as the policies and procedures are consistent with Rule G-30 and are consistently applied.

Under SM .06, the PMP of a municipal security generally will be presumptively established by referring to the dealer’s contemporaneous cost (in the case of a dealer sale to a customer) or contemporaneous proceeds (in the case of a dealer buy from a customer) (the “presumption”). There is no specific time-period that is categorically “contemporaneous.” If a dealer uses a time period as a proxy for what it will view as “contemporaneous,” the development of that proxy must not be arbitrary and must be based on the dealer’s exercise of reasonable diligence. Additionally, the proxy must be consistently applied. SM .06 does not prescribe a bright-line standard for what time period may be used as a reasonable proxy; and a firm’s determination may be informed by case law, industry standards and the dealer’s own experience, among other factors. Where a dealer has multiple contemporaneous purchases (or sales), the dealer may adopt a reasonable methodology to determine contemporaneous cost or proceeds (e.g., an average weighted price or last price

methodology), but the firm must apply such methodology on a consistent basis.

The presumption may be overcome in limited circumstances set forth in SM .06. If the presumption is overcome or is not applicable because the dealer's cost or proceeds are not contemporaneous, three additional categories of factors may be considered to determine the PMP. These three additional categories of factors are: (1) a hierarchy of pricing factors; (2) information regarding similar securities; and (3) economic models. Generally, a subsequent factor or series of factors may be considered only if previous factors are inapplicable, as specified in the provisions governing the category. The three additional categories of factors are described below.

- **Hierarchy of Pricing Factors** — If the presumption is overcome or the dealer has no contemporaneous cost or proceeds, the dealer must consider the following, in the order listed: (i) contemporaneous interdealer transactions; (ii) contemporaneous dealer transactions with institutional accounts; and (iii) if an actively traded security, contemporaneous quotations.
  - ▶ [FAQ 3.19](#) allows dealers to use a reasonable proxy to define whether a transaction is with an institutional customer and specifically states that it would be reasonable to assume that transactions at or above \$1,000,000 par amount would be a reasonable proxy.
- **Similar Securities** — If none of the above factors are applicable, then the dealer may consider other factors, including (but not limited to) prices and yields from contemporaneous transactions in similar securities and yields from contemporaneous quotations for similar securities.
  - ▶ Unlike the hierarchy of pricing factors, similar securities factors may be considered in any order.
  - ▶ Factors that may be used in determining the degree to which a municipal security is similar to the subject security include: credit quality considerations, the spread over an applicable index or U.S. Treasury securities of a similar duration, general structural characteristics and provisions, technical factors and tax treatment.
  - ▶ [FAQ 3.24](#) provides that dealers may use the same process used for [Rule G-18](#) best execution purposes to identify a "similar" security for purposes of SM .06. Alternatively, dealers may adopt a more restrictive approach, as described in [FAQ 3.24](#).

- ▶ Due to the lack of active trading in many municipal securities and the fact that dealers may adopt the more restrictive alternative to identifying similar securities, dealers may not often find information from "similar" securities as compared to dealers in other fixed income markets.

- **Economic Models** — If the PMP cannot be established using any of the above factors, the dealer may consider economic models.
  - ▶ Examples of economic models may include: discounted cash flow models, a reasonable and consistent methodology to be used in connection with an applicable index or benchmark, and third-party evaluated pricing services.

SM .06(a)(viii) provides that isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing PMP.

**Timing of the PMP Determination.** SM .06 applies for both Rule G-15 mark-up disclosure purposes and for Rule G-30 fair pricing purposes. For disclosure purposes, dealers may base their mark-up calculations on the information they have available to them at the time they systematically input relevant transaction information into the systems they use to generate confirmations. For example, a dealer that inputs this information at the end of the day must determine the PMP at the end of the day, while a dealer that inputs this information intra-day may determine the PMP on an intra-day basis when they input the information. Regardless of when the analysis to determine PMP occurs, the objective is always to determine the PMP at the time of trade.

### **Rule G-30: Fair and Reasonable Pricing and Mark-ups**

**Principal Transactions.** Dealers acting in a principal capacity may only purchase or sell municipal securities from, or to, a customer at an aggregate price (including any mark-up) that is fair and reasonable. As part of the aggregate price to the customer, the mark-up also must be fair and reasonable, taking into account all relevant factors. Dealers must exercise reasonable diligence in establishing the market value of the security and the reasonableness of the compensation received on the transaction. For a price to be "fair and reasonable," it must bear a reasonable relationship to the PMP of the security. The dealer compensation on a principal transaction is the mark-up computed from the PMP at the time of the customer transaction, as described in SM .06.

The most important factor in determining whether the aggregate price to the customer is fair and reasonable is that the yield should be comparable to the yield on other securities of comparable quality, maturity, coupon rate and block size then available in the market. Rule G-30, SM .02 also lists other relevant factors, including the total dollar amount of the transaction, the nature of the dealer's business, and the recognition that the dealer is entitled to a profit.

**Agency Transactions.** Dealers acting in an agency capacity must make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions, and a dealer may not purchase or sell municipal securities as agent for a customer for a commission or service charge in excess of a fair and reasonable amount. As noted above, SM .06 applies for mark-up disclosure purposes under Rule G-15 and also for all fair pricing purposes, including agency transactions, under Rule G-30.

Rule G-30 applies to transactions with retail and institutional customers. However, consistent with Rule D-15 and [Rule G-48](#), dealers are relieved of some of their Rule G-30 obligations for a narrow category of agency transactions with sophisticated municipal market professionals (SMMPs). Rule D-15 defines the term "SMMP" and Rule G-48, in relevant part, provides that dealers are not required to ensure that certain non-recommended secondary market agency transactions with SMMPs are effected at fair and reasonable prices.<sup>4</sup>

### Summary of Key MSRB Obligations that may be Relevant to Compliance with the Rule G-15 and Rule G-30 Amendments

In maintaining reasonably designed procedures to comply with the amendments to Rule G-15 and Rule G-30, dealers should be mindful of existing MSRB obligations that may be relevant to their compliance efforts related to Rule G-15 and Rule G-30. Such existing obligations include but are not necessarily limited to those under [Rule G-27](#) and [Rule G-18](#).

#### **Rule G-27: Supervision and Compliance with the Obligations Relating to Mark-up Disclosure, Link Disclosure, Time of Execution Disclosure and Determination of Prevailing Market Price**

**Rule G-27.** Dealers must supervise the municipal securities activities of the firm and its associated persons to ensure

compliance with applicable rules. Dealers also must adopt, maintain and enforce written supervisory procedures reasonably designed to ensure that the conduct of the municipal securities activities of the firm and its associated persons are in compliance with applicable rules. The procedures must codify the dealer's supervisory system for ensuring compliance and, among other things, state how a designated principal will monitor for compliance with all applicable rules and supervise the municipal securities activities of the associated persons.

As noted above, Rule G-30 requires dealers to use reasonable diligence to determine the PMP of a security and dealers may rely on reasonable policies and procedures to implement SM .06, provided that such procedures are consistently applied.

Among other things, dealers should consider whether their policies and procedures describing the implementation of SM .06 address:

- When the firm will determine PMP for disclosure purposes (e.g., at the time of trade, end of day or some time in between);
- The firm's confirmation generation process, including the timing and role of each material step in the process;
- What, if any, objective criteria or proxies the firm will use to implement SM .06 (e.g., how will the firm identify transactions with institutional customers, how will the firm identify whether a transaction is contemporaneous, etc.);
- The firm's exception review process to evaluate PMP determinations, if applicable;
- Under what conditions the firm will correct a confirmation as a result of a change in its determination of PMP after the dealer input relevant information into its confirmation generation system;
- If a firm chooses to assign relative weight, how it will do so for the factors described in paragraphs (a)(v) (regarding the hierarchy of pricing factors) and (a)(vi) (regarding similar securities) of SM .06;
- The process and considerations for identifying similar securities;
- How the firm will identify any non-arm's-length transactions and how it will apply the "look through" to those transactions; and

<sup>4</sup> Under Rule D-15, an SMMP is defined by three essential requirements: the nature of the customer; a determination of customer sophistication by the dealer; and an affirmation by the customer. Notably, the same categories of persons that meet the "non-institutional customer" definition for purposes of Rule G-15 meet the "nature of the customer" requirement under Rule D-15.

- Whether the firm will be using the services of a third-party vendor or clearing firm to determine any of the steps described in SM .06 and, if so, how the firm has or will conduct its due diligence on the service provider and oversee the vendor relationship.

### Rule G-18: Best-Execution

**Rule G-18.** Dealers must use reasonable diligence to ascertain the best market for a security and buy or sell in that market so that the resultant price to a customer is as favorable as possible under prevailing market conditions. Dealers also are prohibited from interjecting a third party between themselves and the best market for the subject security in a manner that is inconsistent with their other best-execution obligations. These obligations are distinct from the fairness and reasonableness of mark-ups and aggregate prices charged, which are governed by Rule G-30. In maintaining policies and procedures designed to comply with the amendments to Rule G-15 and Rule G-30 and when making any changes to trading practices, dealers should remain mindful of their best-execution obligations. Additionally, any intentional delay of a customer execution in order to avoid a mark-up disclosure may be a violation of a dealer's duties under Rule G-18.

## COMPLIANCE CONSIDERATIONS

The following are considerations for dealers in maintaining and assessing their relevant policies and procedures and evaluating their supervisory and compliance frameworks as they relate to mark-up disclosure and PMP. In reviewing the below considerations, dealers should take into account their own business models and relevant facts and circumstances, as some considerations may not apply in the same manner for every firm and others may not apply to a firm at all.

One firm's reasonable policies and procedures designed to comply with the amendments to Rule G-15 and Rule G-30 may look very different from another firm's reasonable policies and procedures. Dealers may wish to consider the following in connection with assessing their policies and procedures:

- **Whether the firm has in place reasonably designed policies and procedures to implement SM .06, in light of the dealer's business model and trading practices.**
  - ▶ **Reasonable Diligence** — Implementation of SM .06 is guided by a standard of reasonable diligence. While dealers may not adopt policies and procedures that are inconsistent with SM .06, where SM .06 allows for a degree of discretion, dealers may

use reasonable policies and procedures that are consistently applied to implement those aspects.

- ▶ **Firm-Specific Policies and Procedures** — There is no one-size-fits-all approach, and one firm's approach may not necessarily be appropriate or reasonable for another firm.

- **Example 1:** Depending on the facts and circumstances, a firm that transacts only when it has an offsetting order in hand may have comparatively streamlined policies and procedures explaining that the firm will use its contemporaneous cost or proceeds and that describe how the firm will determine the PMP in the situations in which it may move off of contemporaneous cost based on the conditions described in SM .06.
- **Example 2:** A firm that transacts primarily with institutional customers and only occasionally with retail customers may have an entirely manual (*i.e.*, not automated) process to determine PMP. In this case, the firm's policies and procedures should describe how it identifies the transactions that require disclosure and how it determines the PMP in accordance with SM .06.

- ▶ **Areas Where Rule G-30, SM .06 Offers Unique Guidance for the Municipal Market** — Rule G-30, SM .06 is closely harmonized with FINRA Rule 2121, SM .02, which addresses the same issues for certain non-municipal fixed income securities. However, there are several areas where the MSRB offered different guidance due to the unique characteristics of the municipal securities market.

- The MSRB expressly allows dealers to adopt a more restrictive approach to identifying similar securities for purposes of Rule G-30, SM .06 than expected for best-execution purposes under Rule G-18. Additionally, the MSRB expressly acknowledges in [FAQ 3.24](#) that dealers in the municipal securities market often may not find information from other similar securities. As a result, the MSRB recognizes that dealers may be likely to use economic models to determine PMP for municipal securities transactions more often than for other fixed income transactions.
- In assessing the degree to which a security is similar to the subject security, the MSRB expressly allows dealers to consider the extent to which the federal and/or state tax treatment of the "similar"

municipal security is comparable to such tax treatment of the subject security.

- Per [FAQ 3.25](#) and its related footnote, the MSRB expressly allows dealers in certain cases to consider information from transactions occurring on both sides of the market (the buy and sell side) at the institutional transactions and quotations categories in the hierarchy of pricing factors stage of the PMP analysis, if done pursuant to reasonable and consistently applied policies and procedures. For example, this may be reasonable where the dealer has identified no comparison transactions in which the dealer is on the opposite side of the market as the dealer in the subject transaction. In this case, the dealer reasonably may adjust a price from a transaction in which the dealer is on the same side of the market as the dealer in the subject transaction by an amount to account for the price at which that transaction might have occurred had it been a transaction in which the dealer was on the opposite side of the market from the dealer in the subject transaction. The MSRB recognized in its FAQs that such information may be particularly important in the municipal market in which securities often trade infrequently and in which dealers may often have such limited information available to them at the time of their PMP determination.
- ▶ **Application of SM .06** — While Rule G-30, SM .06 and FINRA Rule 2121, SM .02 are closely harmonized, the application of these rules could be different. For example, because of the differences noted above and discussed in the relevant rulemaking record, it may be more common for the dealer to resort to an economic model in the municipal market than in other fixed income markets. To the extent that, consistent with Rule G-30, SM .06, dealers use information other than their contemporaneous cost or proceeds to determine the PMP of a municipal security, they may have more PMP outliers and may have more automated PMPs that appear on dealer exception reports. Consistent with [FAQ 3.8.1](#), dealers may correct PMP determinations to promote more accurate mark-up calculations (which is expected to be relatively infrequent), provided they do so according to reasonable and consistently applied policies and procedures. As described elsewhere in this compliance resource, dealers may rely on reasonable policies and procedures to facilitate PMP determination. However, those policies and procedures themselves must be consistent with Rule G-30 and its related guidance.
- ▶ **Use of Vendors** — Per [FAQs 3.6 and 3.7](#), firms may perform some or all of the steps of SM .06 internally or use the services of a vendor or clearing firm. In either case, the firm retains the responsibility for ensuring the PMP is determined in accordance with SM .06. Consider:
  - If applicable, do the firm’s policies and procedures call for due diligence on any third-party evaluated pricing service used as an economic model? How does the firm assess whether the third-party pricing service’s pricing methodologies produce evaluated prices that reflect actual prevailing market prices?
  - Recognizing that a firm can delegate tasks, but not responsibility for compliance, how will the firm monitor the vendor or clearing firm?
- **Whether the firm has reasonably designed policies and procedures to supervise compliance with SM .06 and whether the firm is reasonably supervising its compliance. Consider:**
  - ▶ What system does the firm have in place to monitor overrides of automated PMP determinations, if applicable? How does the firm capture or establish the basis for an override? How does the supervisor supervise the making of overrides and the determination of a corrected PMP for an overridden PMP?
  - ▶ Does the firm have an exception reporting or other process to determine whether PMP outliers were determined in compliance with SM .06?
  - ▶ If the firm has a manual, or partially manual, process to determine PMP, how does the firm reasonably monitor to ensure compliance with SM .06? Have those responsible for performing the manual PMP process received training on SM .06 and the firm’s relevant policies and procedures?
  - ▶ Does the firm consistently apply its relevant policies and procedures?
  - ▶ What documentation does the firm keep to facilitate a supervisor’s supervision of the firm’s compliance with Rule G-15 and Rule G-30?

- **Whether the firm applies SM .06 for purposes of its Rule G-30 fair pricing and fair mark-up determinations. Consider:**
  - ▶ Does the firm capture information, or is it able, on a post-trade basis, to access relevant information to determine whether trades for which mark-up disclosure was not required reflect fair mark-ups and/or fair prices?
  - ▶ Are the firm's policies and procedures for fair pricing and fair mark-up determinations updated to reflect the application of SM .06 beyond the scope of purposes of confirmation disclosure?
- **Whether the firm is disclosing the mark-up on retail customer confirmations as required by Rule G-15. Consider:**
  - ▶ What system does the firm have in place to monitor that mark-ups were disclosed on all applicable confirmations?
  - ▶ What is the firm's process for identifying non-institutional customers? What process does the firm follow to determine that institutional accounts meet the "institutional account" definition?
- **Whether the time of execution and link to EMMA is disclosed on retail customer confirmations as required by Rule G-15. Consider:**
  - ▶ Is the time of execution disclosed on all applicable non-institutional customer confirmations? Is the time of execution displayed on the front of the confirmation as required by Rule G-15?
  - ▶ Is the link to EMMA displayed on all applicable non-institutional customer confirmations? Is the link accompanied by the required explanatory disclosure? Is all of this information displayed on the front of the confirmation?
- **Whether any other MSRB rules are implicated by the firm's relevant practices, processes or procedures. Consider:**
  - ▶ Whether any changes in trading practices designed to facilitate, or avoid, mark-up disclosure compliance also may raise Rule G-18 best-execution concerns (e.g., intermediation and intentional delay of customer executions).

## SUPPLEMENTAL RESOURCES

- [MSRB Confirmation Disclosure and Prevailing Market Price Guidance: Frequently Asked Questions \(March 19, 2018\)](#)
- [MSRB Approval Notice \(November 29, 2016\)](#)
- [SEC Approval Order \(November 23, 2016\)](#)
- [MSRB Response to Comments \(November 14, 2016\)](#)
- [MSRB Amendment No. 1 \(November 14, 2016\)](#)
- [MSRB Filing of Proposed Rule Change \(September 1, 2016\)](#)
- [MSRB Rule G-15: Customer Confirmations](#)
- [MSRB Rule G-18: Best Execution](#)
- [MSRB Rule G-27: Supervision](#)
- [MSRB Rule G-30: Fair Pricing](#)