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June 29, 2012

Mr. Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Dear Mr. Smith,

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to comment on the Municipal Securities Rulemaking Board's ("MSRB" or the "Board) Notice 2012-29, "Request for Comment on Elimination of Large Trade Size Masking on Price Transparency Reports" (the "Notice" or "Proposal"). SIFMA has long supported reasonable initiatives undertaken by the MSRB and others to improve price transparency in the municipal market and other sectors of the capital markets, and we believe it is appropriate for the MSRB to periodically re-examine its policies in this area.

As the MSRB states in the Notice, "transaction information disseminated through RTRS subscription services and displayed on EMMA includes an indicator of '1MM+' for any trade with a par value greater than $1 million." In the Notice, the MSRB is proposing to eliminate the "1MM+" mask for real-time dissemination of trades through the Electronic Municipal Market Access ("EMMA") system and through subscriber services. While we do not believe it would be appropriate for the MSRB to eliminate the mask altogether, we do believe the MSRB could raise the threshold for the mask to some trade size greater than $1 million par amount—say, $5 million—without a significant degradation in liquidity. Eliminating the mask entirely could potentially have a deleterious effect on liquidity and is not justified at this time.

Background

The municipal securities market has a number of characteristics that distinguish it from other sectors of the capital markets:

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[1] The Securities Industry and Financial Markets Association brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

- **The municipal market is fragmented.** There are at least 50,000 distinct issuers of municipal securities with a wide range of characteristics, from states and large cities whose issue sizes are in the hundreds of millions or billions of dollars to small, infrequent issuers who may sell only a few million dollars of bonds every few years. The average new-issue size in the municipal bond market in 2011 was just $27 million.[2] Given that many municipal new issues include multiple maturities, the average maturity size was even smaller. There are millions of individual maturities outstanding (as measured by the number of active CUSIP numbers in the market).
- **The municipal market is less liquid than other sectors of the capital markets.** On average in 2011, 15,213 unique municipal securities traded each day.[3] Given that the number of unique securities outstanding numbers in the millions, this represents a small fraction of all bonds outstanding. Many municipal securities go months or even years between being traded at all.
- **Municipal securities trades are generally small in size.** There were, on average, 41,241 reported secondary market transactions per day in 2011. Of those, only 1,505, or 3.6 percent, were over $1 million par amount.[4] The majority of trades—21,427 per day on average in 2011—are $25,000 par amount or less. Over 82 percent of trades were $100,000 par amount or less in 2011. "Block" trades of over $1 million comprise a relatively small portion of total trading activity.

It is also important to recognize that while some trading in the municipal market involves dealers "crossing" bonds—or executing a purchase from one customer nearly simultaneously with the sale of the same bond to another customer—a significant portion of trading activity in the municipal market involves dealers taking bonds into inventory with no identified buyers. Market liquidity depends on dealers' willingness and ability to put capital at risk by bidding on customers' bonds when requested.

When the MSRB first implemented real-time trade reporting in 2004, and in the "T+1" dissemination system that existed before that, the Board determined that real-time public dissemination of actual large trade sizes could have a negative effect on market liquidity and could disadvantage certain market participants. The MSRB stated, for example, that it "understands that [disseminating] the par value of a transaction tends to allow identification of trading parties, and that this information could be used to the disadvantage of the parties so identified."[5] The 1MM+ mask was adopted in recognition that the "purpose of real-time transparency is to provide price information rather than to identify parties to transactions in real-time."[6]

Disseminating trade sizes potentially threatens liquidity because, as the Board has recognized, knowing the trade size can give potential trading counterparties an advantage in price negotiations. If an institutional investor wants to sell a large block of municipal securities—say, $20 million—the investor seeks bids from dealers. It is unlikely that the dealer who buys the block would already have a buyer

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[2] Thomson Reuters SDC Platinum database.
[3] Municipal Securities Rulemaking Board, *2011 Fact Book*, page 46.
[4] *Id.*, page 45.
[5] Municipal Securities Rulemaking Board, Notice 2004-13.
[6] *Id.*

lined up, so the dealer would take the bonds into its inventory and attempt to sell the bonds to another investor. If the trade amount of the dealer's purchase from the investor were disclosed in real time, investors or other dealers who could potentially buy the block would more easily be able to determine the seller's identity. The dealer attempting to sell the block could find that potential buyers may take advantage of their need to sell and attempt to obtain the bonds at a discounted price. As a result, dealers may be less willing to take on positions from investors in the first place, thereby negatively affecting liquidity. This effect may be particularly pronounced during times of market dislocation or other distressed situations where when bids are requested for a bond, the difference between the strongest bid and successive bids is 5-10 basis points or more.

The MSRB Proposal

In Notice 2012-29, the MSRB is proposing to eliminate the 1MM+ mask and disseminate in real time the actual amount of trades over $1 million par amount. The proposal appears to be based on a reference in a United States Government Accountability Office report citing statements by some institutional investors in the municipal market that "even though MSRB's [Real-time Trade Reporting System] did not disclose total transaction amounts for trades over $1 million—which the system reports as trade amounts of $1+ million—they typically were aware of the amount and price of these large transactions through their relationships with broker-dealers."[7]

Discussion

The Notice requests comment on whether "the masking of trade size has been effective at achieving its initial purpose." The answer is sometimes. Some SIFMA member firms believe that the 1MM+ mask affords them and their customers a degree of anonymity when executing large transactions and that eliminating the mask would make it much easier for competing dealers and others to discern their transactions and positions. Others acknowledge that it is often possible to determine the sizes of trades and sometimes the identities of buyers and sellers involved in large transactions even though the actual trade size is masked in real-time reports. Some firms that regularly engage in large block trades have stated that if the Proposal embodied in Notice 2012-29 is adopted, they may become less willing to bid on investors' positions. Those firms have stated they would be concerned that the real-time disclosure of actual trade sizes would affect their ability to obtain fair pricing when they attempted to liquidate their inventories. Others have stated that eliminating the mask would not have an effect on their market activity.

The Notice also requests comment on whether "there [are] methods, other than receiving direct information from a dealer regarding trade size, for market participants to determine the exact or relative size of large trades and to infer the identity of parties to the transaction from the RTRS trade data history, public filings by certain institutional investors through the SEC's EDGAR system or other sources that otherwise undermine the effectiveness of trade size masking in achieving its initial

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[7] United States Government Accountability Office, "Municipal Securities: Overview of Market Structure, Pricing, and Regulation," January 2012, page 24.

purpose?" While the SEC's EDGAR system probably does not provide a meaningful opportunity for market participants to discern the identities of traders, other sources of information may. There are, for example, publicly available sources of information detailing the portfolio holdings of certain institutional investors.[8] These data may sometimes provide opportunities for market participants to determine actual trade sizes by, for example, comparing investors' positions in individual securities against 1MM+ trade reports. This is not always possible, however, and it is sometimes not possible to reliably determine actual trade sizes for 1MM+ trade reports from publicly available information.

The Notice also requests comment on what would be the justification for retaining the large trade size mask "in light of the GAO findings and the foundational principles for [the Real-time Trade Reporting System]." Simply, many dealer firms believe the concerns the Board expressed in 2004 and earlier which motivated the 1MM+ mask in the first place persist. Unmasking large trade sizes in real time could make it possible, or at least easier, for dealers and investors to discern the identities of participants in those trades. This, in turn, could make dealers less willing to bid on investors' positions, threatening market liquidity. Neither the GAO nor the MSRB have provided any robust or substantive evidence that the concerns that motivated the 1MM+ mask in 2004 are no longer relevant. Indeed, the GAO's discussion of this issue in its January 2012 report comprises just two sentences of the 85-page report. Moreover, if, as the MSRB suggests, some investors are able to discern the actual sizes of large trades "through their relationships with broker-dealers," that was also likely the case in 2004 when the RTRS system was implemented with the 1MM+ mask in place. Market dynamics have not changed significantly since 2005.

Finally, the Notice requests comment on whether there are "alternatives to discontinuing par value masking that would further the initial purpose of such practice while reducing or eliminating the selective dissemination of such information?" The current trade size mask affects less than four percent of secondary municipal market transactions, and we question whether eliminating the mask would contribute significantly to improving market transparency. Nevertheless, we recognize the benefits achieved by the work the MSRB has done in promoting price transparency and making trade information more readily accessible to the market. We suggest that as an alternative to eliminating the 1MM+ mask altogether, the MSRB consider raising the threshold for masked trades to some larger amount, say, trades greater than $5 million par value. This approach would still help protect the identities of dealers who commit to truly large block trades and help preserve dealers' willingness to provide liquidity while enhancing transparency for an even larger segment of the market. According to the MSRB, transactions above $2 million comprised just 2.3 percent of all transactions in 2011.[9] Setting the mask at above $5 million would represent a tiny fraction of market activity and thus would not threaten transparency.

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[8] For example, Thomson Reuters offers a product called eMAXX which provides informational profiles, including portfolio compositions, for many institutional investors.

[9] Municipal Securities Rulemaking Board, *2011 Fact Book*, page 45.

Other Market Sectors

The Financial Industry Regulatory Authority ("FINRA") operates a trade reporting and dissemination system, the Trade Reporting and Compliance Engine ("TRACE"), for transactions in corporate and federal agency bonds and other fixed income securities that is not unlike the MSRB's Real-time Trade Reporting System ("RTRS"). Dealers are required to report transactions in covered securities within 15 minutes of execution, and FINRA publicly disseminates most of those trade reports in real time. The TRACE system includes a trade size mask for transactions in investment-grade corporate bonds larger than $5 million par amount and for transactions in high-yield bonds larger than $1 million.[10] These masks have been in place since the TRACE system was first implemented and were motivated by the same concerns that drove the 1MM+ mask for the RTRS, that disseminating actual large trade sizes in real time could threaten market liquidity.

In addition, the Commodity Futures Trading Commission ("CFTC") earlier this year adopted rules related to real-time reporting and dissemination of the terms of transactions in most over-the-counter swaps.[11] In crafting the rules related to dissemination, the CFTC adopted a series of trade cap masks tailored to particular categories of swaps—interest rate, credit, equity and commodity. For interest rate swaps, the trade size masks are based on the maturity of the contract. The CFTC's trade size masks, based on the notional principal size of swap contracts, are larger than the RTRS or TRACE masks because the swap markets trade differently than the cash markets for municipal, corporate or agency securities. The CFTC has recently proposed further refinement of trade size masks based on more granular distinctions among various categories of swaps, motivated by a desire "to prevent the public disclosure of the identities, business transactions and market positions of swap market participants."[12] The CFTC's sentiment today is the same as the MSRB's in 2004: disclosing the actual amounts of large trade sizes could threaten the anonymity of participants to the trades and could threaten liquidity. The CFTC stated that it adopted the masks "because it believes that market participants' anonymity should be protected."

While the markets for corporate and agency bonds and over-the-counter swaps differ in important respects from the municipal securities market, the same concerns regarding anonymity and liquidity apply to all these sectors. Indeed, the municipal market is arguably more fragmented and less liquid than the markets for corporate or agency bonds or swaps and is potentially more threatened by loss of liquidity attributable large trade size dissemination.

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[10] National Association of Securities Dealers, "NASD Notice to Members 01-18," page 157.
[11] *Federal Register*, "Commodity Futures Trading Commission: Real-Time Public Reporting of Swap Transaction Data," Vol. 77, No. 5, Monday, January 9, 2012, page 1213.
[12] *Federal Register*, "Commodity Futures Trading Commission: Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades," Vol. 77, No. 51, Thursday, March 15, 2012, page 15460.

Conclusion

SIFMA strongly supports reasonable efforts to improve municipal market transparency. We recognize the gains achieved by the MSRB's RTRS system and we believe it is appropriate for the MSRB to examine periodically whether expansions of the system are warranted. However, we believe that neither the MSRB nor the GAO have made a compelling case for eliminating the 1MM+ mask entirely. The concerns that motivated the Board to adopt the mask in 2004 persist today, and other regulators that oversee transaction reporting and dissemination platforms for over-the-counter securities and financial products recognize the need for large trade size masks.

As a compromise measure, we urge the Board to consider raising the threshold for the large trade size mask to $5 million. We believe this approach would improve transparency without significantly threatening market liquidity, and the number of transactions that would continue to be affected by the mask would represent a tiny portion of market activity.

Thank you for the opportunity to comment on the Notice. Please contact us if you have any questions.

Sincerely,

Michael Decker
Managing Director and Co-Head of Municipal Securities

cc: Lynnette Kelly, Executive Director, Municipal Securities Rulemaking Board