



PRICE TRANSPARENCY EFFORTS IN THE MUNICIPAL SECURITIES MARKET

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On June 15, 2000, the Municipal Securities Rulemaking Board (MSRB) filed a proposal with the Securities and Exchange Commission (SEC) to allow it to offer a new Comprehensive Transaction Report. This report would contain pricing and other information on all municipal securities trades for a specific month. The report would be distributed the month after the trades occur.

This proposal is the latest step in a series of efforts taken by the MSRB since the mid-1990's to increase price transparency in the municipal bond market. The following article describes price transparency and its merits and examines the past and future of price transparency proposals.

Why Price Transparency?

The SEC defines price transparency as the extent to which prices are visible and understandable to market participants. Transparency currently plays a fundamental role in promoting fairness and efficiency in U.S. equity markets. Because of the interdependency of bond prices, the most efficient price to be paid for a bond can be inferred from the value of other recently traded bonds.

Price transparency is particularly important to the municipal bond market where investors commonly take long-term positions and trade less frequently. The daily trading volume of municipal securities, therefore, is less than that for corporate bonds and mortgage-backed securities. Because of these unique qualities, price transparency is even more important to municipal bond market participants.

Increased price transparency would provide a number of benefits to both investors and issuers. Investors would receive information on the price and yield of a particular bond, allowing them to make more informed investment decisions.

Issuers will also benefit from an improved secondary market. More information from the secondary market, such as current market value, will allow issuers to evaluate and anticipate investor interest and pricing levels in the primary market. Market liquidity would improve as a result of a

more consistent record of transaction prices — a development that should appeal to issuers.

Increased data in the market will trigger improvements in price analysis throughout the industry. A lack of price information impairs market pricing and weakens competition by raising concerns about fairness of price quotes. Increased price transparency will ensure that investors have access to pricing information and will foster investor confidence in the market.

The Municipal Securities Rulemaking Board and Price Transparency

In 1975, Congress established the MSRB to develop rules regulating banks and securities firms involved in underwriting, trading, and selling municipal securities. The MSRB, which is composed of members from the municipal securities dealer community and the public, sets standards for all municipal securities dealers. Like the New York Stock Exchange or the National Association of Securities Dealers, Inc., the MSRB is self-regulating and subject to the oversight of the SEC.

The MSRB is authorized by Congress to make rules designed to “prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities” [U.S. Code, Title 15, Chapter 2B, Section 78o-4, (b)(2)(C)]

Charged with developing rules to regulate municipal securities dealers, the MSRB is involved with efforts to promote greater price transparency. As originally drafted, Rule G-14, Reports of Sales or Purchases, required a broker or municipal securities dealer who publishes a transaction report to affirm that the transaction was actually effected and that it was not a fictitious transaction. Between 1994 and 1996, the MSRB amended Rule G-14 four times to require brokers and dealers in municipal securities to report

specific information about their inter-dealer and customer transactions using specified formats.

Rule G-14 points out that public reports of market activity are critical to providing transparency and to the compilation of an audit trail for regulatory purposes.

Using the information provided under Rule G-14, the MSRB has generated a series of increasingly more detailed reports which improved price transparency in the municipal securities market. These products include:

Inter-Dealer Daily Report (instituted January 1995)

- Reports only inter-dealer market activity
- Reports frequently traded issues only (defined as four or more transactions per day)¹
- Report includes statistics on total inter-dealer market activity and issue data (volume; high, low, and average prices; and total par value traded)
- Released the day after the trading day
- Reports about 200 transactions per day

Combined Daily Report (instituted August 1998)

- Reports both inter-dealer and customer transactions activity
- Reports about 1,000 transactions per day

Daily Transaction Report (instituted December 1999)

- Reports transaction details on each reported inter-dealer and customer transactions trade
- Report includes statistics on total inter-dealer and customer transactions activities and issue data (volume, price, and par value)
- Reports about 9,000 transactions per day

The Bond Market Association and Price Transparency

In addition to MSRB efforts, the Bond Market Association (TBMA), an industry group representing securities firms and banks that underwrite, trade, and sell debt securities, currently has a free on-line system in place on a TBMA-sponsored website at <http://www.investinginbonds.com>. This system augments MSRB data to promote greater price transparency for municipal bonds and shows, for the most actively traded issues per day, the following data:

- For the issue: description, CUSIP number, credit rating, insurance provider (if any), the name of the issuers' state, coupon, callable maturities, call prices, high and low prices, yield to maturity, and the lower of premium or par call.
- For the trade: time, par traded, price, yield to maturity, and whether it was a customer buy, sell, or inter-dealer trade.

The site is also linked to a service that allows users to review official statements. Additionally, the site permits users to sort the data by various criteria, including state,

yields, credit ratings, prices, maturities, and other important factors.

MSRB's Proposed Comprehensive Transparency Report

As of now, all of the MSRB's reports provide daily information for frequently traded securities (traded four or more times on a given business day) based on the prior day trades. On June 15, 2000, the MSRB filed with the SEC a proposed change to Rule G-14 that would institute a service to provide historical transaction information on all transactions in municipal securities reported to the Board by dealers.

The proposed report, the Comprehensive Transaction Report, would show the trade date, the CUSIP number, security description, par value, time of the trade, price, and yield. Each transaction would be categorized as a sale by a dealer to a customer, a purchase from a customer, or an inter-dealer trade. Because the report would include all transactions, an average of about 29,000 transactions per day would be included. In addition, trades reported late, as well as corrected trades, which are not included on current reports, would be covered. The report, available once a month, would contain the previous month's trading data via CD-ROM at a subscription cost of \$2,000 per year.

MSRB's Comprehensive Transaction Report proposal came about as a result of comments received from prospective subscribers to the current reports. Subscribers noted that they could compile a more complete database of price information to be used to evaluate trades if historical data on frequently traded issues were available. The comprehensive data would also be useful to those studying the market from an academic or market research perspective.

Ultimate Price Transparency Goal: Real-Time Transaction Reports

The MSRB, whose long-term goal is to develop a real-time transaction report, is currently in the early stages of developing a system that will provide information on municipal bond transactions on a real-time basis. A demonstration system now exists on MSRB's website (<http://www.msrb.org>) that uses actual transaction prices reported to the MSRB.

One impediment to a real-time price transparency report is the fact that many dealers use an automated trade processing system that transmits data to the MSRB using an overnight batch method. This method compiles trade information during the day, batches it at night into one file and sends it to the MSRB. These dealers must develop a real-time trade processing system that instantly and directly feeds into MSRB's reporting system.

Another impediment is the fact that there are 1.3 million issues in the municipal bond market and it is impractical to list them all on-line. Instead, the

demonstration system allows the user to view transaction activities for a specific security or for the most frequently traded issues throughout the day. The system reports the following data: CUSIP number, description of issue, par value traded, and the price and yield of the transaction. The system also shows sales by dealers to customers, purchases by dealers from customers, and inter-dealer trades.

Increased price transparency will benefit both investors as well as issuers. The MSRB has taken a number of steps

in recent years to increase transparency through timely, comprehensive reporting. The ultimate goal for the MSRB is to develop a system that will enable users to access transaction information on a real-time basis. Although promising, there are still a few obstacles that need to be overcome before such a system is available. The MSRB is currently soliciting comments about this real-time system. Comment submission instructions are available at its website (<http://www.msrb.org>).

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