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# ACCELERATING EMMA: Time and Price in Municipal Securities Transactions

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**Settlement Time**

One of the great truisms is “Time is Money,” and there is no better exposition of the factors that demonstrate the truth of this statement than “The Price of Time: The Real Story of Interest” by the British financial historian Edward Chancellor (2022). In that book, Chancellor addresses both the history of interest (since the Babylonian Empire) and the critical importance of understanding the costs of future repayment. Perhaps nowhere else in the experience of Americans does the price of things to be done in the future have more currency than in the purchase of a dwelling place or some other major asset (automobile, boat, etc.).

Another area of life where time particularly matters is in the purchase or sale of securities. In the days of paper stock certificates and physical (as opposed to electronic) delivery, disturbing things could happen between the purchase or sale and the time of settlement.

The New York Stock Exchange dates back to 1792 and the Buttonwood Tree Agreement, while the “Curb Exchange” ( American Stock Exchange) was in organized operation by the 1840s. But everything was done by hand, with pieces of paper and in-person delivery.

What would happen if a buyer had a calamitous loss before paying for the stock they wished to own? Or the seller discovered that their counterparty had left the country before paying for the bond they wished to sell? There were any number of efforts to forestall adverse consequences, and yet some less-than-scrupulous folk would seek to make money by selling what they did not own or buying what they speculated would rise in price in the short run. By the 20th century, exchange membership required evidence of substantial financial strength, while the exchanges adopted voluntary rules for settling trades.

By 1934, both the Securities Act of 1933 and the Securities Exchange Act of 1934 (as amended the “1934 Act”) had been signed into law creating a national capital market regulator, the Securities and Exchange Commission (“SEC”). Trading activity was generally left to the market participants, including the exchanges, to regulate. Through the 1920s, settlement was typically accomplished within 1 day, even as clerks and “runners” handled the record keeping and physical delivery of money and of paper certificates. Eventually with the growth of market activity, settlement was to be

completed within a week under the T+5 settlement expectations. After World War II with the enormous increase in securities transactions, back-office operations of market participants were almost "choking" on piles of paper.

As I wrote in my blog "Tightening the Reins: SEC Approves Proposed Rule Change to Clearing Agency Investment Policy," this "Paper Blizzard" led to the creation of clearing agencies, especially the DTC, as Wall Street transitioned to electronic media. That "Blizzard" also led Congress to enact Section 17A of the 1934 Act in 1975, requiring the SEC to adopt a national clearance and settlement system.

Pursuant to Section 17A, the SEC in 1975 promulgated Rule 15c6-1, which at its outset imposed a T+5 settlement period. That period was shortened to T+3 in 1993, and to T+2 in 2017. In February 2023, the SEC amended the Rule once again to require a T+1 settlement cycle, reflecting both the continuing improvement of trading technology and the Commission's concerns about market volatility. As the Commission stated in its Fact Sheet: Reduced Risk in Clearance and Settlement" released on Feb. 15, 2023, and accompanying the Rule's Adopting Release:

> *Two recent episodes of increased [market] volatility – in March 2020 following the outbreak of the COVID-19 pandemic and in January 2021 following heightened interest in certain ["meme"] stocks – highlighted potential vulnerabilities in the U.S. securities market that shortening the standard settlement cycle and improving institutional trade processing can mitigate.*

As four attorneys from White & Case LLP by Colin J. Diamond, Jason Rocha, Daniel Nussen, and Christopher Carreon (2023) state:

> The Commission believes that shortening the settlement cycle will reduce credit, market, and liquidity risks arising from unsettled securities trades… [T]his should reduce the number of unsettled trades overall, the time period of exposure to those unsettled trades, and potential price movements in the securities underlying unsettled trades…. [The shortened settlement period also] will enable investors to access the proceeds from securities transactions sooner.

## Price Information

A closely-related area of capital market regulation is the prompt reporting of transactions so that market participants are aware of trades by others, and particularly informed of the price paid for securities purchased or received for securities sold. This concern manifested itself in both the establishment and development of:

1. the Consolidated Tape Association ("CTA") (as described in my blog "'C.T.A.,' NOT Chicago;" and
2. the Consolidated Audit Trail as most recently discussed in my blog "Compromised CAT: The SEC Seeks a 'Big Brother' of 'Real Time' Market Information."

Indeed, in its May 6, 2020 notice adopting revisions to the CTA, the Commissions stated:

> *[I]t is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to ensure… the prompt, accurate, reliable, and fair collection,*

*processing, distribution, and publication of information with respect to quotations and transactions in [such] securities…*

It is worth noting that the Participants (all Self Regulatory Organizations) in the CAT project "file[d] a new national market system plan [the "Plan"] to replace the three existing national market system plans that govern the public dissemination of real-time, consolidated equity market data for national market system stocks," which caused the SEC to issue a Notice on Jan. 19, 2024 concerning that Plan and soliciting comments. If implemented the Plan would replace the CTA. This is but another step to impose "live" reporting obligations on market participants dealing with equity securities and corporate debt securities. It was too easy to "steal a march" on another investor when the information about price, volume, and even the identity of the buyer or seller were distributed asymmetrically, so that one party had a distinct advantage.

## The Municipal Securities Rulemaking Board

But similar information about transactions in municipal securities was treated significantly differently. Among other reasons, the issuers of municipal securities were not (and still are not) subject to the direct oversight of the SEC. For a fuller description of the structure of regulations of municipal securities and the reasons for them, see my blog "SEC Focus on Municipal Securities: Disclosure and Enforcement – The Peculiar Structure of the Municipal Securities Disclosure Regime."

As part of the same 1975 legislation that added Section 17A to the 1934 Act, Congress added Section 15B to the 1934 Act. Section 15B authorized the creation of the Municipal Securities Rulemaking Board ("MSRB") as a self-regulatory organization (rather akin to the Financial Industry Regulatory Authority ["FINRA"]) subject to the oversight of the SEC to regulate the market for, and the participants dealing with, municipal securities. The MSRB played a crucial role in managing the transition from paper bonds to electronic book entry securities in the 1980s. The authority of the MSRB was enhanced by provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

One of the most significant actions by the MSRB occurred in 2009, when it created the Electronic Municipal Market Access ("EMMA") as a website to record and distribute information about the issuance of and trading in municipal securities.

Although the market for municipal securities is a mere fraction of the size of the markets for equity and corporate debt securities, it is hardly insignificant. The MSRB 2023 Annual Report "Delivering Value to the Municipal Securities Market" issued on Jan. 16, 2024, notes that the "$4 trillion [municipal securities] market… provides access to the capital necessary to build roads, schools, hospitals and other essential public infrastructure in tens of thousands of communities across the country." The Annual Report also notes that the MSRB is now midway through its 2022-2025 Strategic Plan in which the MSRB has advanced and will continue to advance "initiatives that [it] believe[s] will deliver significant value to the market in the coming years."

As a further measure of the scale of the municipal securities market, the MSRB's "2023 Municipal Market Year in Review" issued on Jan. 11, 2024, there were 12.8 million trades of municipal securities reported to the MSRB for 2023 with the PAR value traded $2.25 trillion. The MSRB Review notes that "demand from institutional investors was muted and robust demand from individual investors was the dominant theme in 2023…"

The MSRB Review also notes that "…banks reduced their holdings of municipal bonds" in 2023, particularly after three banks (including Silicon Valley Bank) were taken over by the FDIC. The Review also reports that insurance companies reduced their "holdings of municipal bonds by almost $42 billion through" the first three quarters of the year. Hence, it can safely be said that not only are the amount and volume of municipal securities material to the U.S. economy, but also that the holding of municipal securities by other capital market participants, notably banks and insurance companies, makes the maintenance of a capacious market-place for municipals a matter of importance.

## Time And Price In Municipal Securities Transactions – The Settlement Cycle

In the run-up to year-end, on Dec. 21, 2023, the SEC issued a Notice (the "Notice") that the MSRB proposed to amend Rule G-12 to require parties (brokers, dealers, municipal securities dealers, and their institutional customers) to municipal securities transactions to complete the "allocations, confirmations, and affirmations by the end of [the] trade date." The MSRB requested that the change to Rule G-12 take effect on May 28, 2024, the date that SEC Rules 15c6-1 (amended) and new 15c6-2 (requiring T+1 settlements of equity and corporate debt transactions) go into effect.

As the Notice states, "[t]he proposed rule change would align with the same-day allocation, confirmation, and affirmation process for equities and corporate bonds under [the new SEC rules]."

The proposed change to Rule G-12 would:

> *[R]equire dealers effecting municipal securities transactions subject to the T+1 settlement cycle to either enter into written agreements as specified in the proposed rule change or establish, maintain, and enforce written policies and procedures reasonably designed to address certain objectives related to completing allocations, confirmations, and affirmations as soon as technologically practicable and no later than the end of [the] trade date.*

Basically, the rule change will prohibit market participants from using a settlement cycle other than T+1, unless the parties have entered into a written agreement to do so. The Notice further notes that:

> *[T]he terms "confirmation" and "affirmation" refer to the transmission of messages among dealers, institutional investors, and custodian banks to confirm the terms of a trade executed for an institutional investor… consistent with how such terms are used in [Rule 15c6-2]. Additionally, the term "allocation" refers to the process by which an institutional investor (often an investment adviser) allocates a large trade among various client accounts or determines how to apportion securities trades ordered contemporaneously on behalf of multiple funds or non-fund clients…*

The Notice explains that if the written agreement option is chosen, all "relevant parties" must agree, where "relevant parties" includes investment advisers, custodians, and other agents who participate in the settlement process. As part of that explanation, a participant is not in violation of the Rule even if one of the other participants fails to meet its obligation so "long as the written agreement describes the obligations of the parties to ensure the allocation, confirmation, or affirmation of the transaction."

The Notice then outlines the five minimum requirements for "policies and procedures reasonably designed" to implement a T+1 settlement cycle." They are as follows:

1. Detailed identification of the technology systems used to coordinate with other relevant parties;
2. Establish time frames for completing settlements;
3. Detail the procedures to ensure the prompt communication of trade information, including investigating any discrepancies;
4. Describe how a dealer will deal with delays, if another party does not promptly complete settlements; and
5. Monitor and document the rates of compliant settlements not later than the end of the day of the trades.

The Notice also reports on the estimated costs of compliance with the amended Rule according to the MSRB, namely $44,440 per firm to implement the T+1 systems and some $3,448 of annual updates and recordkeeping. The MSRB as part of that discussion noted that market participants who also deal in equity and corporate debt securities will have to comply with new Rule 15c6-2, so that the proposed amendment to MSRB Rule G-12 will impose at most minimal additional burdens on them.

> *For the remaining limited number of municipal dealers who only trade municipal securities, the estimated upfront costs would be relatively minor though necessary… the estimated annual ongoing costs would also be minor and would be proportional to each firm's trading activities.*

Hence, the MSRB concludes that "any broader impact on competition in the municipal securities market is expected to be minor..." The MSRB noted that it did consider alternative approaches but concluded that those approaches would not necessarily lead to uniformity in the marketplace. In connection with the proposal, the MSRB also noted that it received an unsolicited supporting letter from the Securities Industry and Financial Market Association ("SIFMA," the principal trade association for all market participants) urging consistency with the SEC's T+1 settlement rule for transactions involving equity securities and corporate bonds. In that same vein, the MSRB asserts that:

> *[T]his alignment of the regulatory scheme will foster greater cooperation and coordination among the MSRB and the Commission and Financial Industry Regulatory Authority, as well as greater cooperation and coordination among the authorities that examine dealers for compliance with MSRB rules.*

The Notice requests submission of comments within 45 days of publication in the Federal Register or such longer period (up to 90 days), as the SEC may announce, after which the SEC will approve or disapprove the proposal.

## Time And Price In Municipal Securities Transactions – Price Information

Then on Friday, Jan. 12, 2024, the MSRB filed proposed amendments to MSRB Rule G-14 to "change the current 15-minute standard to as soon as practicable, but no later than one minute after the time of trade" of municipal securities to report the trade to MSRB for disclosure on EMMA. The MSRB CEO declared that this was designed to improve "the transparency of the municipal securities market." In its Jan. 12 Press Release, the MSRB noted that in August 2022, it had sought comments from market participants concerning a one-minute trade reporting rule, which had engendered a "robust response." The MSRB had then:

*engaged in additional analysis and extensive engagement with market [participants] to understand why certain types of voice-brokered, block and other trade types might not currently be readily reportable within one minute, as well as to understand potential resource or other barriers to meeting a new one-minute timeframe that might exist for some firms, including smaller or less active firms.*

In the words of the MSRB Chief Regulatory and Policy Officer, cited in the Press Release:

> *The proposal filed today represents a carefully crafted modernization of the trade reporting paradigm that we believe will result in substantial improvements in making more contemporaneous prices available to investors and other market participants.*

Then on Friday 19 Jan. 19 2024 the Commission issued a 116-page Notice (the "Notice") of the proposed MSRB Rule G-14 amendment to require that trades in municipal securities to be reported within one minute of occurrence. The Notice observes:

> *Fixed income markets have changed dramatically since the current 15-minute requirement went into effect in 2005, including a significant increase in the use of electronic trading platforms or other electronic communication protocols to facilitate the execution of transactions.*

The proposed amended Rule would have certain limited exceptions including:

1. a 15-minute exception for dealers with "limited trading activity;"
2. a phased in transition from 15 minutes to 5 minutes for "trades with a manual component;";
3. maintaining all existing exceptions to the current 15-minute reporting requirement; and
4. requiring the use of a "special condition indicator" for trades with a manual component.

In addition, any "'pattern or practice' of late trade reporting without 'reasonable justification or exceptional circumstances'" is a violation of the MSRB Rule.

The Notice reports on the many comments received by the MSRB in response to its 2022 solicitation of comments from market participants and discusses possible alternatives considered and rejected. The SEC requests that any further comments or objections be submitted to the Commission within 21 days of publication in the Federal Register.

## The Parallel Proposal By FINRA Regarding Trace

On Jan. 11 2024, the SEC also issued a Notice (the "FINRA Notice") that FINRA (the Financial Industry Regulatory Authority) proposes to require one-minute trade reporting of transactions on Trade Reporting and Compliance Engine ("TRACE"), which is the principal platform for trading U.S. Treasuries. See my blog "Tracking Treasury Trades: The Fed to Collect the TRACEs." The FINRA Notice spells out the developments in the trading of Treasuries "in the intervening 18 years since FINRA first adopted the 15-minute reporting requirement…" It further notes that it is proposing the change "to modernize the reporting timeframes and provide timelier transparency." Once again comments and objections are to be submitted to the Commission within 21 days of publication in the Federal Register.

## Closing Observations

One can see that these MSRB and the FINRA proposals both attempt to close the “window” of time within which to conclude a trade in a municipal security AND to open the “window” on transaction price. It is not without a certain irony that as this blog was being finished, Chair Gary Gensler of the SEC gave a speech to the European Commission entitled “Time is Money. Time is Risk” in which he reviewed in detail the pending changes to the settlement process for equity securities and corporate bonds. Gensler urged his European audience to seek to implement T+1 on European exchanges, noting:

> *…the market plumbing of clearing and settling matters. As most homeowners know when the plumbing is backed up…well, things get messy. So too in our capital markets.*

As I noted at the outset and as found in “The Price of Time,” ***time*** is always a key factor in economic activity, and perhaps especially in the securities markets. With the adoption of amendments to MSRB Rules G-12 and G-14 the once “backwater” of the market for municipal securities will, much like Kansas City’s NPR news podcast, have everything “Up To Date.”

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