BLACKROCK INSIGHTS

BlackRock®

MSRB RULE

Municipal Bonds: Increased Disclosures and Declining Inventory

Highlights

- Effective May 14th 2018, the Securities and Exchange Commission* (SEC) requires brokerage firms to disclose the pricing mark-up or mark-down on many corporate, agency and municipal bond trades to retail investors.
- Reduced dealer inventory and liquidity in the municipal bond market has contributed to trading costs that remain higher relative to equities, particularly for small-scale investors.
- These developments continue to signal a shift away from individual bonds toward managed fixed income strategies.

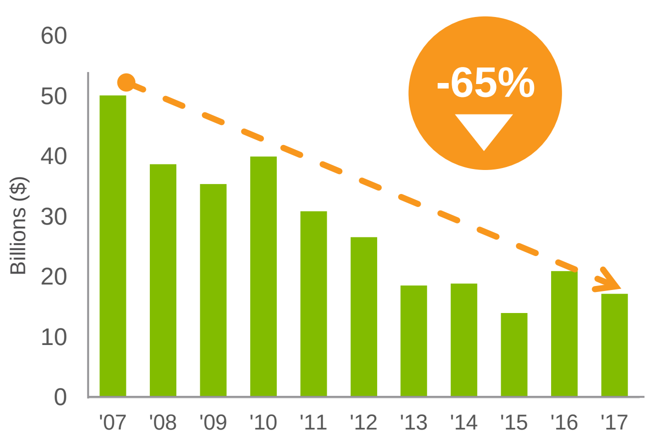
About the Regulatory Landscape

On May 14th 2018, the Municipal Securities Rulemaking Board (MSRB) implemented a rule that requires brokerage firms to disclose to retail investors the pricing mark-up or mark-down on many corporate, agency and municipal bond trades.

While individual bond trades typically do not involve a commission, some involve a transaction cost that, in the form of a mark-up or mark-down, is borne by, but not necessarily disclosed to retail investors. Because bonds aren't exchange-traded and lack readily accessible market prices, regulators have sought to increase the overall transparency to bring reporting standards more in line with those surrounding equity trades.

Less municipal bonds on hand

Broker-dealer inventories, 2007-2017



Source: BlackRock analysis sourced from Federal Reserve Board, Flow of Funds Accounts (Table L.212), as of 12/31/17.

Under the rules, bond pricing details must be disclosed on investors' trade confirmation statements. This disclosure is now required when many bonds are bought and sold by the dealer within the same trading day. More specifically, when a broker sells to a retail customer as principal, and on the same day buys the same security as principal from another party, the firm has to disclose on the retail buyer's trade confirmation: 1) the price charged to the customer, 2) the price to the firm of the same-day trade (reference price) and 3) the difference between those two prices. These disclosure requirements may affect upwards of 8,000 retail transactions each day in municipal securities alone.[1]

*Amended rule is MSRB Rule G-15, "Confirmation, Clearance, Settlement and Other Uniform Practice Requirements with Respect to Transactions with Customers."

While costs for individuals transacting in small quantities of bonds have declined in recent years, they remain significantly higher than those seen on comparably-sized stock trades.[2] Reduced dealer inventory within the municipal bond market may be one contributing factor.

Uncovering bond transaction costs
Implied transaction cost for various asset types

Bond type	Average implied transaction cost
Investment-grade municipals	1.11%
High yield municipals	1.93%
Investment-grade corporates	1.01%
High yield corporates	1.74%
Equities	~0.006%

Source: BlackRock, S&P Dow Jones Indices "Unveiling the Hidden Cost of Retail Bond Buying & Selling," August 2016. Reflects average implied transaction cost to retail investors as of June 2016. Indexes used were the S&P National AMT-Free Municipal Bond Index, the S&P Municipal Bond High Yield Index, the S&P U.S. Issued Investment Grade Corporate Bond Index and the S&P U.S. Issued High Yield Corporate Bond Index. Implied transaction cost for equities based on average per trade cost of $6.15 across the five largest discount brokers on a $100,000 trade.

Visit blackrock.com/sma to learn more about BlackRock Managed Accounts

1 Source: Municipal Securities Rulemaking Board, November 18, 2016.
2 Source: S&P Dow Jones Indices, "Unveiling the Hidden Cost of Retail Bond Buying & Selling," August 2016. Average transaction costs for retail trades under $100,000 across investment-grade municipals and corporates, and high-yield municipals and corporates have fallen from 2.08% to 1.21%, 1.44% to 0.85%, 2.47% to 2.10%, and 2.38% to 1.62% between 2011 and 2015, respectively.

Investing involves risk, including possible loss of principal. Fixed income risks include interest-rate and credit risk. Typically, when interest rates rise, there is a corresponding decline in bond values. Credit risk refers to the possibility that the bond issuer will not be able to make principal and interest payments. There may be less information available on the financial condition of issuers of municipal securities than for public corporations. The market for municipal bonds may be less liquid than for taxable bonds. A portion of the income may be taxable. Some investors may be subject to Alternative Minimum Tax (AMT). Capital gains distributions, if any, are taxable.

This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed are as of May 2018, and may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and nonproprietary sources deemed by BlackRock to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader. This material has been prepared for information purposes only and is not intended to provide, and should not be relied on for, accounting, legal, or tax advice.

Not FDIC Insured • May Lose Value • No Bank Guarantee

Lit. No. MSRB-CF-0518

BLACKROCK®

MKTG0518U-497207-1564060