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MSRB, FINRA Propose Principal Trade Disclosure.

WASHINGTON -Two self-regulators are proposing rules that would require dealers acting as principals to disclose to customers on their confirmations a "reference price" of the same security traded that same day as well as the difference between that price and the customer's price.

The Municipal Securities Rulemaking Board and the Financial Industry Regulatory Association are asking for public comments to be filed on the proposals no later than Jan. 20

The draft amendments to the MSRB's Rule G-15 on confirmation would apply to principal transactions of $100,000 or less, which the regulators are proposing to classify as "retail-sized" trades. The MSRB rule covers municipal bonds. FINRA has responsibility for enforcing MSRB rules under Securities and Exchange Commission supervision. FINRA's proposal covers fixed income securities in general.

The MSRB announced in August that it would propose this rule in an effort to attempt to address concerns about hidden markups in so-called "riskless principal transactions," when bonds are bought and sold within a short period of time so the dealer has little risk the market will change.

"Our approach takes information already available to the public online but provides it directly to retail investors at the time of the transaction, enabling them to more easily evaluate their transaction costs," said MSRB executive director Lynnette Kelly.

There have been increasingly loud calls for dealers to disclose their markups on riskless principal transactions, with Securities and Exchange Commission chair Mary Jo White and Commissioners Michael Piwowar and Daniel Gallagher sounding the call in recent months.

Additionally, Sens. Mark Warner, D-Va. and Tom Coburn, R-Okla., introduced a bill in March that would require disclosure of such markups. The SEC recommended that the MSRB consider requiring disclosure of pricing reference information to retail investors as part of a series of price transparency recommendations in its unanimously-approved 2012 Report on the Municipal Securities Market.

The proposal would not be the same as requiring disclosure of markups. For a customer sale of munis to a dealer, the dealer would have to disclose pricing information for same-day transactions in which it sold those bonds in a principal capacity. For a customer purchase from the dealer, the dealer would be required to disclose pricing information for same-day transactions in which it purchased the bonds in a principal capacity.

"While this differential is not necessarily the same as a markup, it can provide the investor increased price transparency and significant insight into the market for the security," the board wrote in the proposal. "An analysis of this differential may also achieve many of the objectives of an explicit markup disclosure requirement."

The MSRB's Rule G-30 on prices and commission requires that muni prices be fair and reasonable,

but does not require dealers to disclose their compensation or transaction costs, which are often factored into customer prices.

Rule G-15 currently requires dealers to disclose on a confirmation the price of a municipal securities transaction, but they are not required to disclose their markups on principal transactions. There were attempts by the SEC in both the 1970s and the 1990s to require such disclosure, but heavy industry resistance stalled it both times. Dealers have said that defining a trade as "riskless" is problematic and that compliance difficulties could hamper the market.

FINRA and the MSRB are seeking input on the likely economic implications of the proposals as well as on alternative regulatory approaches, including a potential markup disclosure requirement meant to specifically target trades that could be considered "riskless." The MSRB could also alter other aspects of the proposal, such as changing the $100,000 threshold. The proposal suggests that adopting it as a rule would enhance competition between dealers while also changing the competitive landscape.

"Retail customers will have information that will allow them to make more informed choices about which dealers to use for future transactions, incentivizing dealers to offer competitive prices in retail transactions," the board wrote in the proposal. "It is possible that the costs associated with the requirements of the proposal relative to the baseline may lead some dealers to reduce services to retail investors. In some cases, the costs could lead smaller dealers to consolidate with larger dealers or to exit the market."

Jessica Giroux, Bond Dealers of America senior counsel and managing director for federal regulatory policy, said BDA has been awaiting the proposal and wants to work with regulators to ensure any rule changes address a specific market problem.

"The BDA has been anticipating the release of these notices since SEC Chair Mary Jo White announced her intention to examine so-called 'riskless principal transactions' over the summer and since then, the BDA has been working proactively with the SEC, FINRA, and the MSRB to discuss the best approach to such a proposal by urging regulators to ensure that the pricing disclosure solves a defined problem and creates meaningful information for the retail investors and in the appropriate context," Giroux said.

David Cohen, managing director and associate general counsel at the Securities Industry and Financial Markets Association, said SIFMA supports increasing transparency in the municipal market in a cost-effective way.

"The MSRB proposal correctly identifies several considerations to the construction and cost of the proposed disclosure and further identifies alternative approaches," Cohen said. "We feel that it is important to note that much of this information is currently available to retail investors on EMMA."

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