Bond Case Briefs

Municipal Finance Law Since 1971

MSRB: Dealers Would Have to Disclose Markups on Principal Transactions.

WASHINGTON — Dealers acting as principals would have to disclose markups and markdowns in transactions with retail customers under rule changes proposed by the Municipal Securities Rulemaking Board.

The proposed change to MSRB Rule G-15 on confirmations is the first of its kind in more than 20 years and follows what has been a nearly 40-year discussion about the need for markup disclosure in the market. The MSRB is seeking comment on the components of its markup disclosure proposal as well as on alternatives. It is asking that those comments be filed by Nov. 20.

Bond Dealers of America and Securities Industry and Financial Markets Association both said they are reviewing the changes with their members before submitting comment letters by the November deadline. Jessica Giroux, BDA's general counsel and managing director of federal regulatory policy, said BDA is "encouraged" by the MSRB's use of previous comments in drafting its new proposal, such as the exclusions of primary offerings and institutional customers.

Under the markup proposal, a dealer buying or selling bonds for its own account would be required to disclose the markup or markdown on a customer's confirmation when: it executes a transaction on the same side of the market as the customer; the transaction is greater than or equal to the size of the customer's; and the dealer transaction occurs within a two-hour window on either side of the customer transaction.

Those markups and markdowns would be equal to the "difference between the price to the customer and the prevailing market price for the security," and would have to be disclosed both as a total dollar amount and as a percentage of the principal amount of the customer transaction, according to the MSRB. Even if the markup did not have to be disclosed, a dealer would have to provide the investor a hyperlink and URL address to the Security Details page for the security on EMMA as well as a time of execution for the customer's trade.

The MSRB would also try to limit this proposed rule to the secondary market by excluding transactions in new issue securities effected at the list offering price by members of the underwriting group.

There are also two organizational caveats to the rule. If a dealer is executing a transaction from an affiliate's inventory of munis, the rule would require the dealer to "look through" to the affiliate's transactions with the "street" and other customers to see if the affiliate had a same-side of the market transaction within the two-hour window. Dealers that have independently operating trading desks would be exempt from disclosing markups if they could prove that the customer transaction occurred separately from the principal trading desk that executed the dealer's same-side market transaction and that the desk was not aware of the retail customer transaction.

Lynnette Kelly, the MSRB's executive director, said the disclosure requirements would provide investors "a way to understand the true costs of their municipal securities transactions."

“Our new proposed approach would offer greater clarity for investors as to dealer compensation while leveraging the existing processes and systems dealers use to comply with their fair-pricing obligations,” she said.

The MSRB previously proposed changing its Rule G-15 in November 2014 to require dealers to disclose on their confirmations a “reference price” of the same security traded on the same day. FINRA proposed a similar rule for corporate bonds. But muni dealers said the reference price rule was too complex and would confuse investors. They asked the MSRB to withdraw it. FINRA has said it also will modify its proposal because of criticism and solicit a second round of comments. But the authority only plans to propose a revised version of the reference price rule it floated earlier.

The MSRB also included modifications to the “reference price” rule in its regulatory notice, although the board noted it would prefer markup disclosure. The board asked commenters to weigh in on whether disclosing a reference price is a better alternative to markup disclosure.

The reference price rule modifications largely mirror the requirements laid out in the markup disclosure proposal. The MSRB is asking whether the reference price rule should: include all retail investors regardless of the trade size cap that was used in the initial proposal; apply exclusively to the secondary market; disclose a total dollar amount as well as a percentage; require a security specific link as well as the time of execution; and offer similar exceptions for inventory-affiliate dealers and independent trading desks.

Securities and Exchange Commission members have been pushing for markup disclosure, and more aggressively since the commission’s enforcement action against Edward Jones in August for overcharging retail customers for sales of new bonds and failing to adequately supervise mark-ups on secondary market trades.

Just after the SEC announced that settlement, four of the five SEC commissioners urged that broker-dealers be required to disclose markups and markdowns on munis, warning that they were ready to make the proposals themselves if self-regulators did not pursue them. SEC chair Mary Jo White did not join the other commissioners in the statement, but previously said she would work with self-regulators to develop rules requiring markup disclosure in riskless principal transactions.

THE BOND BUYER

BY JACK CASEY
SEP 25, 2015 2:09pm ET

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com