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Dealers Want MSRB, FINRA to Adopt Same, Less Costly Markup Proposals.

WASHINGTON – Dealer groups want the Municipal Securities Rulemaking Board and Financial Industry Regulatory Authority to adopt the same approach, but one that is less costly and burdensome, for requiring dealers acting as principals to disclose to retail customers the markups and markdowns on muni trades.

The self-regulators' proposals are not currently aligned. The Securities Industry and Financial Markets Association also is urging them to allow dealers to choose between several approaches.

The groups made their comments in responding to the MSRB and FINRA markup proposals.

The MSRB, initially proposed dealers disclose on their confirmations a "reference price" of the same security traded on the same day, but changed course in late September after receiving complaints. Instead it proposed requiring dealers to disclose markups, which it defined as "the difference between the price to the customer and the prevailing market price for the security." In its proposed changes to MSRB Rule G-15 on confirmation, the MSRB also asked commenters to weigh in on whether their previous reference price idea would be a better fit for the market.

FINRA's proposal more closely resembles the MSRB's original reference price idea and would require dealers to disclose the differential between the price to the customer and the dealer's reference price.

Bond Dealers of America and SIFMA both said they appreciate the regulated efforts and support giving customers more information, but are troubled by the differing proposals from the two regulators. The MSRB and FINRA must adopt identical requirements and language for any final rule, they said. Any rule would also have to include specific guidance on acceptable ways of determining a markup or reference price under the regulation.

"As currently formulated, the proposals lack necessary specificity, present unworkable challenges in application and operation, risk misleading the very customers they are intended to protect, and have the potential to undermine bond market liquidity," SIFMA said in a joint letter from associate general counsel and co-head of the municipal securities division Leslie Norwood and managing director of the capital markets division Sean Davy.

BDA chief executive officer Mike Nicholas said BDA "strongly urges regulators to pursue a harmonized rule that represents the least cost, least complex, and most understandable disclosure method," which neither of the regulators' proposals would accomplish, as written.

Under the MSRB's 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 two-hours of the customer transaction.

Those markups and markdowns 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 muni on EMMA, as well as a time of execution for the customer's trade.

The MSRB would limit this proposed rule to the secondary market by excluding transactions in new issue securities executed 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.

SIFMA said it agrees with the MSRB's proposal to limit the rule to retail investors and also supports the two-hour time window, which "generally would provide pricing information that is more representative of the market at the time of the customer transaction." The group added that the timeframe would address any concerns that firms would wait to trade outside of the two-hour limit because MSRB data shows 96% of all trades that were followed by another trade in the same municipal security on the same day had the second trade occur within two hours.

BDA said it would prefer the disclosure instead be based on a full trading day, as FINRA has proposed, because it would minimize technology costs and operational complexity that would come from a shorter time period.

Both groups agreed that the MSRB's proposal would result in substantial costs on dealers and urged further study of the cost-benefit breakdown of implementing such a rule. SIFMA said the costs and burdens would be "enormous" because of necessary technology changes and ongoing considerations like compliance reviews, internal audits, and training of personnel.

A better solution, according to SIFMA, would be to give firms a flexible framework that would allow them to choose to adopt something either similar to FINRA's framework, or the MSRB's proposed standard, or a different standard that would fit into the regulators' goal of disclosing reference prices, subject to further guidance.

Some firms already disclose markups, whether they use a prevailing market price disclosure framework or some other method, SIFMA said. A system that gives flexibility instead of a single standard may fit better in the existing dealer community, Norwood and Davy added.

One example SIFMA suggested is to allow firms to use a Cusip-specific volume weighted average price, produced by EMMA, as a reference for customers on confirmations. Using a VWAP may also be easier to explain to customers, Norwood and Davy said. It also would lower the cost of implementation because firms would be able to use regulators' already existing systems for the information instead of having to develop their own.

Nicholas made a similar argument in his letter saying use of the centralized data on EMMA is the "least complex, lowest cost proposal" available.

"BDA recommends that regulators leverage the transaction data that they already hold to provide

the type of retail confirmation disclosure the proposals are designed to create," he said. "This method represents a more efficient way of delivering a confirmation disclosure."

If the MSRB decides to pursue something similar to its current proposal, SIFMA asked that dealers have at least three years to implement the necessary changes because they will also be preparing for an industry-wide switch to a two-day settlement cycle.

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