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Bill Sets the Stage for Riskless Principal Regs.

WASHINGTON — A bipartisan bill quietly introduced in the Senate months ago may serve as a starting point for key discussions among regulators about how to develop rules requiring dealers to disclose markups on "riskless principal" transactions.

The Bond Transparency Act of 2014, sponsored by Sens. Mark Warner, D-Va. and Tom Coburn, R-Okla., was introduced in March. The bill would require dealers to disclose to their customers, in writing, at or before the time of completion of a riskless principal transaction, the amount of the difference between the customer's price and the dealer's price. These transactions have not been formally defined, but are generally understood to mean purchases and sales done almost simultaneously so there is little or no chance that the market could move against the dealer.

The idea of requiring dealers to disclose markups in riskless principal transactions is not new, and was included in the Securities and Exchange Commission's 2012 muni market report. More recently SEC Commissioner Michael Piwowar has called for disclosures of such markups, and SEC chair Mary Jo White has instructed the Municipal Securities Rulemaking Board and the Financial Industry Regulatory Authority to begin work on a framework for that purpose.

The SEC does not need legislative authority from Congress to require markup disclosure, but sources said the introduction of the bill could have prodded the SEC into action.

Warner and Coburn introduced the bill after a column appearing in The Wall Street Journal claimed muni investor's profits were being eaten up by markups.

"When buying or selling shares in a stock, customers are told the commission they pay; it only makes sense that the same occur when trading a bond," Warner told The Bond Buyer. "I am encouraged chair White has made our commonsense, bipartisan idea of bond price transparency a priority and that MSRB and FINRA are moving forward on this. I hope they can move expeditiously to protect investors and strengthen our markets."

The bill does not define riskless principal beyond saying it means the dealer is "acting as principal for its own account" leaving it to the SEC to decide what the appropriate standard should be.

The question for the dealer community is how the regulators plan to define a riskless principal. Were the Warner/Coburn bill to become law, a dealer would have to tell a customer at the time of the transaction what the markup would be. In a speech in Boston last week, Piwowar said that the SEC staff's initial opinion is that a same-day time frame to identify riskless principal transactions would be workable for market participants. Piwowar added that he is looking forward to "seeing further analysis on this issue and hearing from market participants on their views."

David Cohen, a managing director and associate general counsel at the Securities Industry and Financial Markets Association, said the support of the dealer community for the new disclosures and the Bond Transparency Act depends on the riskless principal definition.

“SIFMA believes that the bill is a good starting point for discussion,” Cohen said, adding that a trade is only riskless if a dealer has a firm customer order in hand before committing to the trade. Whatever definition of riskless principal the commission decides on, Cohen said, it has to be measurable so that it can be automated.

The MSRB had initial discussions at its board meeting last week on how it will approach the new mandate. White said in June that she wants a disclosure framework in place by the end of the year.

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