
New Bond Rules Target Large Broker Fees.

WASHINGTON — U.S. regulators, moving against what they see as abusive practices in the municipal- and corporate-bond markets, are poised to crack down on large fees that can eat into investor returns.

Regulators are putting the finishing touches on new rules to require brokers to disclose how much they pocket when they buy certain corporate or municipal bonds, then sell the same securities to mom-and-pop investors later that day, according to people familiar with the regulators' plans.

The Financial Industry Regulatory Authority, Wall Street's self-regulator, is expected to finalize the rules next Thursday while the Municipal Securities Rulemaking Board, a sister agency, is expected to adopt nearly identical rules soon. The rules are subject to Securities and Exchange Commission review, and could change before they are put into practice.

The disclosures aim to address long-standing concerns among regulators that everyday investors who buy bonds don't know how much they are paying in broker fees. Regulators also say some investors are charged significantly higher prices for the same or similar securities.

Individuals own lots of bonds: U.S. households hold about $1.5 trillion of municipal paper and about $600 billion of corporate debt, according to the Federal Reserve. Regulators say the new requirements would apply to at least 25,000 daily trades between brokers and individual investors.

At present, many brokers don't disclose their markups. That means investors don't understand the fees and can't compare transaction costs across different firms.

The markup rules could deliver a blow to the brokerage units of large banks like Morgan Stanley that have said the approaches under consideration would be too difficult to implement. The rules are backed by discount brokers Charles Schwab & Co. and Fidelity Investments, which already charge low, flat fees on retail trades.

"We think this is a good move by the regulators to create more transparency for investors," said Jeff Brown, head of regulatory and legislative affairs at Schwab.

"We believe the markup disclosures should apply to all retail fixed-income transactions, not just those that occur within a particular time period," said Stephen Austin, a spokesman for Fidelity.

A spokesman for Morgan Stanley referred to a December comment letter objecting to earlier versions of the rules. At the time, the bank said determining an exact markup would be too difficult for firms with "substantial balance sheets of continuously changing inventory."

The push for more price transparency has been a focus for the SEC, which oversees Finra and the MSRB, for the past few years. In a July 2012 report on trading in the municipal-bond market, the agency wrote that the lack of price transparency undermines the fairness of the $3.7 trillion market.

A Finra spokesman declined to comment. MSRB Chief Legal Officer Robert Fippinger said the board has been working closely with Finra “on a coordinated approach.”

The rules have been in the works for more than two years but gained added momentum last summer, when the brokerage Edward Jones agreed to pay the SEC $20 million to settle charges that the St. Louis-based firm and a former employee improperly sold new bonds to customers at prices higher than those negotiated with the bonds’ issuers. The case prompted four of the SEC’s commissioners at the time to prod the MSRB and Finra to complete the rules.

Progress has been slow, in part because Finra and the MSRB couldn’t agree on the same approach until recently, said people familiar with the matter. In addition to retail markups, brokers also will have to disclose markdowns, or the haircuts individual investors receive when selling their bonds.

Michael Nicholas, chief executive of Bond Dealers of America, an industry group, said dealers “need significant guidance” on how to calculate markups, especially for less frequently traded municipal and corporate bonds.

The MSRB on Thursday proposed guidance for dealers to help them calculate markups.

The markup disclosures are geared to principal trades, in which a broker buys a bond for its own account and later in the day sells it to an individual client.

Under the approach Finra and the MSRB are expected to adopt, brokers will have to disclose markups on any retail trade if the firm bought the same security earlier that day. That time period is broader than a two-hour window the MSRB had proposed last year. Some SEC officials feared that shorter window could be too easily gamed by brokers seeking to avoid the disclosures.

Brokers also will have to calculate the markups based on a bond’s “prevailing market price,” generally what it cost the broker to buy the security, unless there is a market event that causes the bond’s price to change.

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