Bond Case Briefs

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Regulatory Changes Put Spotlight On Bond Pricing, Disclosure.

From Invesco: Effective May 14, 2018, new regulations will be adopted aimed at increasing the transparency of bond pricing. The new rules require dealers of corporate, municipal and agency bonds to clearly disclose bond markups and provide retail investors with relevant price comparisons.

Although this initiative was spearheaded by the Municipal Securities Regulatory Board (MSRB) to cover municipal bonds, the Financial Industry Regulatory Authority (FINRA) has been working in tandem with the MSRB on language that covers corporate and agency bonds as well. Ultimately, the two regulatory agencies came up with similar sets of rules approved by the Securities and Exchange Commission that will be unveiled on the same timeline.

As retail investors discover the real cost of owning individual bonds, we believe these regulatory changes will strengthen the case for both fixed income exchange-traded funds (ETFs) and active fixed income investment managers.

What are bond markups?

When selling bonds, a dealer may acquire the bonds at one price and then sell them for a higher price as compensation for the dealer's services. Markups represent the spread between the price paid for a bond and the price the dealer receives when selling the bond. Seeing the need to "enhance the transparency of costs associated with municipal securities transactions," in November 2016 the MSRB amended existing Rules G-15 and G-30, which cover confirmation, clearance, prices and commissions. Working in concert with the MSRB, FINRA drafted disclosure requirements that are "materially the same" as the MSRB's.1 The rule changes for both agencies take effect on May 14 and target non-institutional investors.

What has changed?

1. Increased disclosure around bond markups

In a nutshell, the new rules require bond dealers to disclose any markups (or markdowns) on bonds bought and sold to retail investors on the same day. Markups and markdowns must be expressed both in dollar terms and as a percentage of each bond's prevailing market price.1

In order to make these disclosure requirements meaningful, retail investors must understand a bond's prevailing market price. That is the other key component of the rule changes.

2. Determining prevailing market prices

In the case of municipals, dealers will be required to provide a hyperlink to the MSRB's website, which hosts publicly available trading data for each security.1 Presumably, the data would allow retail investors to assess the fairness of the prices being charged by bond dealers. Because of its broader regulatory reach, FINRA offers its member firms wider latitude in disclosing prevailing market prices. Regardless of how members choose to disclose prevailing market prices, however, the "timing of the determination must be applied consistently across all transactions in corporate and agency debt securities."2

Ramifications for retail investors

US bond trading volume eclipses that of the equity markets by a large margin. Nonetheless, bond markets have long been shrouded in mystery. Unlike stocks, bonds are traded over the counter rather than on standardized exchanges. This means that bond pricing is less transparent and trades are often conducted on a one-off basis through informal networks of dealers. As a result, bond pricing can be confusing, while US bond markets can be inaccessible to retail investors. We believe these changes should help de-mystify bond pricing.

We believe these regulatory changes also highlight the benefits of managed fixed income strategies. Invesco offers a broad lineup of active and passive fixed income strategies covering municipals, investment grade and high yield asset classes. Our fixed income professionals are experienced in navigating the complexities of the bond markets. In fact, Invesco Fixed Income is a leading global fixed income manager — focused entirely on helping clients meet their investment objectives. And because of Invesco Fixed Income's global scale, we are able to purchase bonds in large blocks and secure institutional pricing.

Investors who currently invest in individual bonds might wish to consider our BulletShares suite of ETFs, which offers the precision and flexibility of individual bonds with the cost and tax efficiency of the ETF structure.3 BulletShares ETFs encompass both investment grade and high yield corporate bonds, enabling investors to build customized portfolios tailored to specific maturity profiles, risk preferences and investment goals.

Choosing Invesco as your fixed income partner can help simplify fixed income investing.