

Client Alert

Current Issues Relevant to Our Clients

November 19, 2014

FINRA and MSRB Request Comment on Pricing Disclosures for Fixed-Income Security Trade Confirmations

The Financial Industry Regulatory Authority, Inc. (“FINRA”) and the Municipal Securities Rulemaking Board (“MSRB”) recently requested comment on proposals to require disclosure of pricing information on customer trade confirmations for certain fixed income security transactions. The proposals would require dealers, in “retail-size” customer transactions, to disclose on the customer confirmation (1) the price of certain same-day principal trades in the same security, (2) the customer’s price for the security and (3) the difference between these two prices. The FINRA and MSRB proposals are substantially similar; however FINRA and the MSRB are soliciting comments on factors specific to corporate and municipal bonds, respectively. You may submit comments for both proposals through January 20, 2015. The related FINRA notice is available [here](#). The related MSRB notice is available [here](#).

Background

The FINRA and MSRB proposals respond to a 2012 Securities and Exchange Commission (“SEC”) report on the municipal securities market and subsequent comments from SEC Chair Mary Jo White calling for disclosure of mark-ups and mark-downs for “risk-less principal” transactions in both the corporate and municipal bond markets. Current rules do not require dealers to disclose the amount of mark-ups or mark-downs for principal transactions in fixed-income securities. As a result, FINRA and the MSRB have proposed to amend existing rules regarding customer trade confirmations to provide disclosure of recent trade prices directly to customers for certain “retail-sized” transactions. Trade prices are currently available on the MSRB’s Electronic Municipal Market Access (“EMMA”) and FINRA’s Trade Reporting and Compliance Engine (“TRACE”). Both organizations hope that additional disclosure will increase price transparency.

FINRA and MSRB Proposals Require Disclosure of Same-Day, Retail-Sized Principal Transactions

Both proposals would require dealers to provide additional disclosure on customer trade confirmations when the dealer executes any retail-sized transaction with a customer and also executes a transaction as principal with one or multiple parties for the same security within the same trading day. Under both proposals, a “retail-size” transaction would mean a purchase or sale transaction with a customer of 100 bonds or less or bonds with a par/face amount of \$100,000 or less. Under FINRA rules,

the term “customer” does not include a broker or dealer. Under MSRB rules, a “customer” means any person other than a broker, dealer, or municipal securities dealer acting in its capacity as such or an issuer in transactions involving the sale by the issuer of a new issue of its securities. Accordingly, the current proposals do not apply to inter-dealer trade confirmations but do apply to transactions with an institutional investor in an amount less than or equal to 100 bonds or \$100,000 par/face amount.

The dealer would only need to disclose a transaction or transactions to a customer when the size of the dealer’s transaction(s) in the same security on the same trading day would meet or exceed the size of the customer’s transaction and the dealer is on the same side of the transaction as the customer. For example, if, on the same trading day, a dealer purchases 50 bonds from another dealer at a price of 100 each and then sells 50 of the same bonds to a customer at a price of 102 each, the proposals would require the customer trade confirmation to disclose the price to the dealer (100), the price to the customer (102) and the price differential (2). On the other hand, if a dealer purchases 50 bonds from another dealer at a price of 100 each on one day and then sells 50 of the same bonds to a customer at a price of 102 each on the following day, the proposals would not require any disclosure to the customer because the trades did not occur on the same-day. Similarly, if, on the same trading day, a dealer purchases 125 bonds from another dealer at a price of 100 each and then sells 125 of the same bonds to an individual retail customer at a price of 102, even though the customer is an individual retail investor the proposals would not require any disclosure to the customer because the customer transaction is greater than 100 bonds and \$100,000 par/face amount.

While the FINRA and MSRB proposals are similar in both intent and substance, the text of the amendments differs, which may require additional clarification and harmonization before the proposals become effective.

[FINRA Proposal Requires Disclosure of Price to Dealers, Price to Customers, and Difference in Price](#)

The FINRA proposal would amend FINRA Rule 2232 on customer trade confirmations, which currently does not include any specific requirements as to fixed-income security transactions. With respect to a sale to or purchase from a customer of retail-size involving a corporate or agency debt security, where a dealer also executes a buy or sell transaction(s) as principal with one or multiple parties in the same security within the same trading day that meets or exceeds the size of the customer transaction, the amended rule would require the dealer to disclose: (i) the price to the dealer; (ii) the price to the customer; and (iii) the differential between the two prices in its customer trade confirmations. It is worth noting that this price differential is not necessarily the same as the mark-up or mark-down on a bond transaction as governed by FINRA Rule 2121, especially where the dealer's principal transaction and the customer transaction were not contemporaneous or close in time.

[MSRB Proposal Requires Disclosure of Price to Dealer and Difference in Price](#)

The MSRB proposal would amend MSRB Rule G-15, which governs customer trade confirmations, among other things. The amended rule would require customer confirmations to disclose: (i) the price for any "reference transaction" (as defined in the rule); and (ii) the difference in price between the reference transaction and the customer trade, expressed as a percentage of par. Unlike the current FINRA rule, current MSRB Rule G-15 already includes requirements to disclose yield and price on customer transactions. The MSRB release defines "reference transaction" as a transaction in which the dealer transacts: (1) in a principal capacity; (2) with a third party to purchase or sell municipal securities; (3) in the same security as the customer; (4) on the same side of the transaction as the customer (as purchaser or seller); (5) on the same date as the customer transaction; and (6) in a single trade amount that equals or exceeds the size of the customer transaction or in a trade amount that, when combined with one or more other transactions that meet these requirements, equals or exceeds the size of the customer transaction. Similar to the FINRA proposal, it is worth noting that this price differential is not necessarily the same as the mark-up or mark-down on a bond transaction as governed by MSRB Rule G-30, especially where the dealer's principal transaction and the customer transaction were not contemporaneous or close in time.

[FINRA Release Provides Examples of Required Disclosures](#)

The FINRA release provides thirteen examples to demonstrate which transactions dealers are required to disclose and how dealers should interpret the rule's requirements, particularly where a dealer executes multiple principal transactions in the same security as customer transactions on the same-day. The release provides that when multiple dealer transactions equal the amount of the customer transaction, the dealer must provide the weighted average price of the dealer transactions in its customer confirmation. For example, when a dealer purchases 40 bonds at a price of 100 and 60 bonds at a price of 99, then sells 100 bonds to a customer at a price of 99.70, the dealer would need to disclose the weighted average of the price to the firm (99.40), the price to the customer (99.70) and the difference between the two prices (0.30). The release also provides that when a dealer engages in multiple transactions which in aggregate exceeds the number of securities in the customer transaction, the dealer would apply a last in, first out methodology that would refer to the dealer transaction(s) closest in time proximity to the customer transaction. While the MSRB notice does not contain multiple examples of how its proposed rule would operate, the MSRB notice specifically requests comments on several of the interpretive examples included in the FINRA notice.

[Submitting Comments](#)

You may submit comments on the proposed MSRB and FINRA rule changes on or before January 20, 2015. Comments on the MSRB proposal may be submitted by hard copy or through MSRB's internal comment form available [here](#). Comments on the FINRA proposal may be submitted by hard copy or email to pubcom@finra.org.

[For More Information](#)

To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group, or visit us online at chapman.com.

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