

Chapman Client Alert

November 23, 2016

Current Issues Relevant to Our Clients

SEC Approves Rules Requiring Bond Mark-ups/Mark-downs on Trade Confirmations

The Securities and Exchange Commission (the “SEC”) recently approved Financial Industry Regulatory Authority, Inc. (“FINRA”) and Municipal Securities Rulemaking Board (the “MSRB”) rule amendments requiring broker-dealers to disclose trade compensation for certain fixed income securities principal transactions with retail customers. The amended rules will require broker-dealers to disclose their mark-up or mark-down from the “prevailing market price” of the security. The rule amendments also provide guidance on determinations of the “prevailing market price” for a security. The final rules are substantially similar to the rule proposals described in our September 2016 Client Alert on the MSRB proposal available [here](#) and our August 2016 Client Alert on the FINRA proposal available [here](#).

The New Disclosure Requirement

Rule 10b-10 under the Securities Exchange Act of 1934 and MSRB Rule G-15 generally require that a broker-dealer acting in an *agency* capacity disclose the amount of any remuneration (e.g., a commission) received from its customer in connection with a transaction in fixed income securities. However, current rules do not require a broker-dealer acting in a *principal* capacity with its customer to disclose the amount of its mark-up or mark-down in the transaction.

The revised rules will require a broker-dealer to disclose its mark-up or mark-down from the prevailing market price for the security if the firm sells or buys a corporate debt security, agency debt security or municipal security to or from a “non-institutional” customer and on the same day has an offsetting sale or purchase as principal of the same security to or from a third party in an equal or greater amount. A “non-institutional” customer is a customer with an account that is not an “institutional account,” as defined in FINRA Rule 4512(c) or MSRB Rule G-8(a)(xi), as applicable.

The revised rules will require the mark-up or mark-down to be shown as both a total dollar amount and as a percentage of the prevailing market price. The confirmation will also have to include the execution time and a reference (and hyperlink if the confirmation is electronic) to trade-price data in the security from FINRA’s Trade Reporting and Compliance Engine (TRACE) website or the MSRB’s Electronic Municipal Market Access (EMMA) website. The disclosure requirement will generally not apply to securities acquired in a fixed-price offering or list offering price transaction, as defined under FINRA and MSRB rules, respectively. The revised MSRB requirement also does not apply to municipal fund securities, such as 529 college savings plans.

Extended Implementation Period

The new requirements will be effective in approximately 18 months. FINRA and the MSRB extended the implementation period from one year to 18 months in recognition of the challenges presented to the industry by the new disclosure requirements. FINRA and the MSRB will publish specific effective dates and implementation information in forthcoming regulatory notices.

Additional Explanatory Language on Confirms and Voluntary Disclosure

Firms should note that they are permitted to include mark-up and mark-down disclosure on all retail customer trade confirmations even when not required under the new rules or on all customer confirmations (retail and institutional customers). Firms may find broader disclosure more technologically feasible or less confusing for investors. FINRA and the MSRB also noted that firms are permitted to include explanatory language or disclosures on confirmations to provide context and

understanding for investors as long as the language is accurate and not misleading. For example, these explanations could explain “prevailing market price” as a concept, provide detail about the firm’s methodology for determining “prevailing market price,” note the availability of such information on request or explain how the mark-up/mark-down disclosure was derived. Firms may not, however, label the mark-up/mark-down disclosures (or “prevailing market price”) as “estimated” or “approximate.”

For More Information

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