Prevailing Market Price

Critical Issues Ahead of Deadline

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Fixed income participants have less than two months until the May 14th deadline for the implementation of the mark-up disclosure rule and the implementation of the PMP 'waterfall' approach for fixed income.

In February of 2016, the Financial Industry Regulatory Authority's Board of Governors approved a proposal designed to help retail customers understand and compare transaction costs in fixed-income securities. The mark-up disclosure rule generally requires firms to disclose on the customer confirmation the firm's mark-ups and mark-downs based on a "Prevailing Market Price" (PMP) on bonds bought and sold to retail customers on the same day that they are bought or sold for the firm's own account.

The rule offers guidance on how firms should determine a PMP, establishing a multi-step 'waterfall' approach to determining its value. While the regulation only applies to retail trades completed on the same trading day as principal trades, many firms are choosing to disclose mark-ups and mark-downs on all retail transactions to ensure consistent reporting on client confirms.

A reasonable timeline for integration of PMP is no less than 12 months. In reality, we have learned that many large firms have just begun to focus on a solution and some smaller firms believe they can do it manually. PMP is no small undertaking, and regardless of the approach, firms need the full timeline to evaluate their options, develop their solution, implement them and test. Now that market participants are well past any reasonable timeline, we wanted to outline the most critical issues facing large and small firms as the clock continues to countdown.

INTEGRATION COMPLEXITIES GROW

Integration issues and challenges are faced by both large firms that control the entire workflow and by smaller firms that do not. For those smaller firms, coordinating multiple 3rd party vendor systems only amplifies the integration challenges. We have found that the crucial steps to integrating multi-layered and highly complex processes requires far more time than the industry has between now and the May 14th deadline. Some of the most daunting work can be found

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through the task of integrating solutions with front and back-office systems. For the larger firms, it is almost impossible for them to stop or take offline critical integration paths that can span 20 operating systems. With so many touch points, the PMP integration process with legacy systems can be highly challenging since the introduction of new connections adds stability risks that only can be mitigated by adequate testing. Firms of all sizes are especially worried about the possible instability stemming from a limited testing period that can result in issues that could take systems down.

The critical steps required for compliance with a deadline lurking right around the corner.
Example for illustrative purposes only.

TESTING AND ACCURACY

Appropriate testing should take months and must be accomplished on every level. Testing must include connectivity, security, performance, business continuity, record retention and accuracy. In addition, it must also include the PMP solution, the integration of data inputs, outputs and the resulting confirms. Regulated entities, without systems in place by March, will be left with inadequate time for proper testing. The real risk of limited testing is publishing varied and incorrect numbers on a customer confirmation, which is an important legal document.

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THE FINAL PMP COUNTDOWN

Calculating the PMP value accurately, resulting in a value that truly reflects the dealer's compensation for its customer trades, is only the first step of the entire process. Once a solution is chosen, the next hurdle is getting it implemented and adequately tested. The multiple challenges associated with adopting the appropriate solution for this rule requires a high level of precision and a one-size-fits-all approach generally fits none well. Due to the bifurcated nature of liquidity and execution in fixed income, firms must seek solutions that are designed with an open architecture that can support integration with any execution platform. Integration, testing and accuracy will continue to haunt firms, both large and small, that have fallen behind the proposed PMP timeline.

ABOUT BONDWAVE LLC

BondWave is a financial technology company specializing in fixed income solutions. We serve a wide range of customers, from small independent RIAs to some of the largest broker-dealers and custody providers in the financial services industry. Traders and advisors use our tools to provide a superior fixed income experience to their clients. By creating sophisticated, yet simple solutions for all stakeholders in the investment process, we help traders and advisors better leverage individual bonds as they work to achieve the investment objectives of their clients. Our tools enable strategy-based investing – including portfolio creation, monitoring and rebalancing – while greatly enhancing the communications between the trading desk, advisors and their clients. BondWave is liquidity and trade agnostic and our sole focus is to provide a simple, sophisticated user experience around individual bond investing.

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