Bond Case Briefs

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Bond Dealers of America - 2014 Year in Review.

Regulations & Securities Law

FINRA Margin Amendments

In January, FINRA published a request for comment on proposed amendments to Rule 4210—margin rules for the TBA market. The proposed amendments would require the collection of margin for exposures greater than $250,000 on a variety of transactions on which there is currently no margin requirement.

In March, BDA submitted a comment letter to FINRA asking for certain specific changes which would enable FINRA to meet their goals while reducing the burden to small and middle market dealer firms. Following up on that letter, BDA has met and worked closely with FINRA senior staff to provide workable changes to the published amendments. We are awaiting submission of those updated amendments to the SEC and intend to reengage on this issue with both FINRA and the SEC.

- FINRA's proposed amendments to Rule 4210 are available here.
- BDA's comment letter to FINRA is available here.

Clarifying SEC Rule 15c2-12

In November, the SEC filed a notice in the Federal Register soliciting comments on the regulatory burden for underwriters and issuers associated with Rule 15c2-12 compliance. Specifically, the SEC is seeking comments on "ways to enhance the quality, utility, and clarity" of information collected pursuant to 15c2-12.

Improving and clarifying 15c2-12 was a topic that BDA members raised directly with the Office of Municipal Securities in October during a DC member fly-in. Comments are due on January 20th and BDA is currently working on drafting a comment letter.

- The SEC notice on 15c2-12 is available here.

Private Placement Activity

In October, BDA wrote to the SEC and the MSRB to inform regulators that non-dealer MAs might be violating securities law in certain instances by acting as unregistered dealers in private placements.

In mid-December, the National Association of Municipal Advisors (NAMA) responded by sending a letter to regulators that argued for an exemption for registered MAs to make dealer activities permissible. The Bond Buyer ran a story about NAMA's letter.

BDA responded to NAMA's letter and published a Commentary in the Bond Buyer that highlighted the flaws in NAMA's analysis. Additionally, the BDA is currently drafting a letter to regulators as a follow-up. The follow-up letter will include specific policy recommendations for regulators to consider should they seek to make policy changes.

- BDA letters to SEC and MSRB are available here.
- Bond Buyer article about NAMA exemption request is here.
- BDA Bond Buyer Commentary is available here.

MSRB Best Execution

On December 5, 2014, the SEC approved the MSRB's Rule G-18 establishing best execution standards for municipal securities. The best execution rule will require municipal securities dealers to use "reasonable diligence" to identify the best potential trading venue for a particular security and then execute transactions in that venue to provide the customer with a price as favorable as possible under prevailing market conditions.

The BDA submitted several comment letters to the MSRB and SEC and in October, the BDA met with the SEC, MSRB, and FINRA to discuss the rule's expansive definition of "market." Additionally, based on those meetings, we submitted a comment letter requesting a bifurcated approach, which would have allowed a Sophisticated Municipal Market Professional (SMMP) to opt-in to best execution without losing SMMP status. The rule was adopted without these changes, however, over the course of the next few months, the BDA plans to work with the MSRB to inform its development of interpretive guidance surrounding the rule. The rule will take effect December 7, 2015.

- The MSRB's regulatory notice is available here.
- The BDA's comment letter to the SEC on G-18 is available here.
- The BDA's comment letter to the MSRB on G-18 is available here.
- The BDA's letter asking for a bifurcated approach to establishing SMMP designations is available here.

MSRB and FINRA Pricing Information Disclosure Proposal

In November, FINRA and the MSRB each released rule proposals to require dealers to disclose markups on certain retail trades. The draft rule would require dealers to disclose markups on trades of 100 bonds or $100,000 or less when they have entered into a principal trade on the same day in the same security.

BDA is currently working on a comment letter for submission to FINRA and MSRB by January 20th. The letter will focus on the significant costs of upgrading systems to comply with this additional confirmation disclosure.

- The FINRA and MSRB regulatory notices can be found here.

FINRA CARDS Proposal

In October, FINRA released a proposed rule to implement the Comprehensive Automated Risk Data System (CARDS). CARDS would alter FINRA's examination and surveillance programs in a significant way by requiring dealers to submit account and transaction information for each of its customers to FINRA on monthly basis. FINRA would then house the data and run analyses designed to identify regulatory infractions.

In late October, BDA member firms met with FINRA senior staff in Washington, D.C. to discuss the cyber security concerns and cost issues related to CARDS.

On December 1, 2014 BDA submitted a comment letter to FINRA expressing concerns with the costs of CARDS and also expressed skepticism in FINRA's ability to protect CARDS data from a cyber attack.

- FINRA's proposed rule is here.
- BDA's comment letter to FINRA is here.

SEC MCDC

BDA worked to secure modifications to the SEC's Municipal Continuing Disclosure Cooperation (MCDC) initiative, including advocating for tiered civil penalty caps to reduce the disproportionate burden for smaller firms active in the municipal market. In addition, BDA partnered with trade groups including GFOA, NABL and SIFMA to educate staff and Members on Capitol Hill. We also sent an industry letter asking for certain additional modifications to the initiative beyond those that the SEC offered.

Further, BDA worked with members and staff on Capitol Hill to request their assistance with outreach to the SEC prior to the deadline for underwriter self-reporting deadline.

BDA's initial letter and follow up letter to SEC regarding MCDC are available here.

Request for Municipal Bond Inclusion as High Quality Liquid Assets in Banking Liquidity Rule

In September, federal banking regulators approved a final rule to implement the Liquidity Coverage Ratio (LCR). The LCR requires banks with $50 billion or greater in total assets to identify a specific set of High Quality Liquid Assets (HQLA) that the bank could sell to raise cash in the event of a liquidity crisis. The rule was approved and currently municipal bonds are not eligible for treatment as HQLA.

BDA has consistently argued that munis should be included in a bank's stock of HQLA. Staff at the Federal Reserve has recommended the inclusion of municipal bonds in HQLA. An amended final rule is forthcoming. BDA will continue to track this issue and push for inclusion.

MSRB Municipal Advisor Regulatory Regime

The MSRB is developing a series of rules and amendments to regulate previously unregulated municipal advisors. Below are the MSRB's key proposals issued this year and the BDA's corresponding comment letters.

G-44

The SEC approved MSRB Rule G-44 October 23, which establishes baseline supervisory and compliance obligations for municipal advisors.

The BDA submitted comment letters to both the MSRB and SEC during the comment solicitation process. You can view the BDA's April 2014 letter to the MSRB and our August 2014 letter to the SEC here.

The new supervision requirements take effect April 23, 2015.

G-42

The MSRB proposed draft amendments to Rule G-42 to establish the core duties of municipal advisors when providing advice on municipal securities transactions and related products. The BDA submitted a comment letter on March 10, 2014 and the MSRB issued a revised draft Rule G-42 on July 23, 2014, which incorporated a number of changes made by the MSRB to the rule text based upon comments received from the industry. Some of these changes were in direct response to the

BDA's suggestions in our March 2014 comment letter. On August 25, the BDA submitted a comment letter to the MSRB regarding the revised rule, focusing on BDA's support for the MSRB's revised approach to principal transactions, with one further request for clarification; review of recommendations and a request that the MSRB provide specific language that permits the use of reasonable policies and procedures in certain instances; reference to Rule G-23 and a desire for further clarification; and allowances for acting as Underwriter for Conduit Issuer and Municipal Advisor for Obligated Person.

You can find our March 2014 letter and our August 2014 letter here.

G-37

On August 18, 2014, the MSRB requested comments on draft amendments to Rule G-37, the MSRB's pay-to-play rule for municipal securities dealers that would extend the rule to municipal advisors. You can view the full regulatory notice here. BDA submitted a comment letter generally supporting the MSRB's efforts in creating a level playing field between dealers and municipal advisors.

You can find our full comment letter here.

G-20

The MSRB issued a request for comment on October 23, 2014 to extend the provisions of its Rule G-20 on gifts, gratuities, and non-cash compensation to apply to non-dealer municipal advisors.

The BDA submitted a comment letter expressing our general support for extending the provisions to non-dealer municipal advisors, with a couple of reservations including a request for clarification on what constitutes an "entertainment expense" prohibited from reimbursement and what constitutes normal travel costs. The BDA also requested an alignment of recordkeeping requirements for municipal advisors and dealers.

G-3

On November 19, 2014, the MSRB announced the filing of the proposed amendments to Rule G-3 on professional qualification requirements for municipal advisors with the SEC.

The amendments create a standard of professional qualification for municipal advisors and establish two classifications of municipal advisor professionals: representative and principal.

You can read text of MSRB's proposal here and BDA's G-3 comment letter here.

The amended rule took effect January 1, 2015.

Municipal Advisor Compliance

The BDA is actively engaged in assisting members by facilitating useful discussions regarding MA rule compliance. In July, outside counsel Nixon Peabody prepared "The Municipal Advisor Rule: Receiving Advice from your Broker-Dealer Regarding Investments". The paper provides factual and concise answers to common questions regarding the MA rule and investment advice.

The paper is available here.

IRS Issue Price

In September 2013, the IRS proposed arbitrage rules, which would remove the ability of

underwriters to establish an issue price using reasonable expectations and contain an unworkable safe harbor for establishing issue price. The BDA submitted comments in 2013 and in February 2014 testified before the Internal Revenue Service and Treasury Department regarding the need for a reasonable expectations standard. We have also met with senior staff at the IRS and Treasury regarding the impacts of their proposed regulations. Treasury and IRS staff indicated that they understand, based upon numerous comments submitted, that the rule as proposed will need to be made more clear and flexible prior to finalization. Furthermore, Treasury and the IRS have indicated that they will publish further guidance on issue price as a priority item for them in 2015. The BDA intends to meet again soon with senior staff at both the IRS and Treasury.

Legislation

Bank Qualified Bonds

Rep. Tom Reed (R-NY) introduced the Municipal Bond Market Support Act (HR 5199) in July 2014. HR 5199 would permanently increase the bank qualified annual debt limit from $10 million to $30 million, index that amount for inflation, and apply it to individual borrowers. Bank qualified debt allows small governments and authorities to directly place their debt with banks, particularly community banks, and the banks are then able to deduct a percentage of the carrying costs for purchasing these bonds as with their other investments. The legislation has bipartisan support with five cosponsors, and the support of more than 20 state and local government and industry associations including the BDA. We have been working closely with Rep. Reed's and the bill's cosponsors' offices in getting the bill introduced over two sessions of Congress. We will continue to educate other members of Congress on the issue and work to get the bill reintroduced in the 114th Congress.

Tax-Exempt Bonds

Now-retired House Ways and Means Committee Chairman Dave Camp (R-MI) unveiled his long-awaited tax reform draft in 2014, which included several provisions that would negatively impact municipal bonds. The draft included a new 10 percent surtax that would apply to municipal bond interest income (among other income). It also included a provision to eliminate private-activity bonds and advance refunds of bonds.

In his FY 2014 budget request President Obama reiterated his proposal to cap the tax exemption of municipal bond interest at 28 percent. In his budget Obama also proposed a new America Fast Forward (AFF) Bond program. AFF bonds would be direct-pay bonds with a 28 percent subsidy rate that could be used to fund infrastructure projects and other kind of projects that had been funded by the now expired Build America Bonds program (BABs).

In addition, several studies and reports have cited the tax exemption for municipal bonds as a significant expenditure, which increases the threat that eliminating or limiting the exemption could be used as an offset for other legislation.

BDA has and continues to work directly with key congressional offices, taking the lead on the effort to prevent the modification or elimination of the tax exemption for municipal bonds from being included in tax reform, budget, and other legislation. We continue to work with our industry partners including many issuers and state and local groups through the Municipal Bonds for America (MBFA) Coalition. The MBFA's efforts have been reinvigorated throughout 2014, with a growing membership and strengthening strategy for educating Congress on tax-exempt bonds. With Rep. Paul Ryan becoming the new Chairman of the House Ways and Means Committee and Senator Orrin Hatch (R-UT) becoming the new Chairman of the Senate Finance Committee, BDA will work

with these key offices in the 114th Congress to provide education on tax-exempt bonds as tax reform discussions progress.

Events

BDA events, roundtables, and training seminars all drew record participation in 2014. BDA brought member firms together to discuss the top market, regulatory, and legislative issues facing the U.S. fixed income markets. In addition, BDA events and member fly-ins created opportunities for members to interact directly with top regulators.

In 2015, the BDA will continue to offer meaningful, interactive trainings and roundtables on the most critical issues facing the dealer community. Furthermore, the BDA will design DC “fly in” days for member firms to interact directly with Members of Congress, top Congressional staff, and the regulatory community.

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