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Markup Rule Deadline May Be Hard To Meet.

Municipal market participants may not be ready in time to implement a pending markup disclosure rule on which regulators place huge importance.

Amendments to Municipal Securities Rulemaking Board Rules G-15 on confirmation and G-30 on prices and commissions, which are to take effect on May 14, 2018, will require dealers to disclose their markups and markdowns on certain transactions in the confirmations they send retail customers — a sea change for the municipal market. MSRB executive director Lynnette Kelly has called the rule changes "a game changer." Both the MSRB and Financial Industry Regulatory Authority have put significant effort into providing firms with education about the rule changes.

But as the clock ticks down toward the compliance date, many in the industry worry they will not be able to put in place changes that will allow their automated systems to comply with the new requirements.

Under the rule changes, markup disclosures will have to be given as a total dollar amount and a percentage of the prevailing market price.

The amendments establish a "waterfall" of factors for determining the PMP. Dealers initially are to look at their contemporaneous trades of the same muni with other dealers or customers to establish a presumption of prevailing market price. If that data is unavailable, they must make a series of other successive considerations. They can look at contemporaneous trades of the muni in interdealer trades, then trades of the muni between other dealers and institutional investors, then trades on alternative trading systems or other electronic platforms.

Further down the waterfall, firms can look at contemporaneous trades of similar securities. The MSRB included a list of "non-exclusive factors" like credit quality, size of the issue, and comparable yield that can be used to determine if securities are similar. The bottom of the waterfall allows dealers to use prices or yields derived from economic models.

While complicated, most dealers think that they can comply with the rule changes, whether internally or through a third-party vendor. But what many are far less sure about is whether they will be prepared, by May 14, to automate the process from transaction to delivering the customer a confirmation with a properly-disclosed markup or markdown. A number of dealer representatives made that point while speaking at an MSRB roundtable earlier this month.

"The clock is ticking on this year, and we don't have a solution in hand to automate the waterfall," Daren Colaiacovo, a director of retail trading at RBC Capital Markets said at the roundtable. "It's something we're taking very seriously."

Colaiacovo said that while several vendors are offering PMP calculation solutions for markup rule compliance, he is not aware that any firm has their solution in hand and is set to go.

Kristin Maher, head of fixed income services at Wells Fargo, said Wells has tested solutions with

several vendors but is still working out how to automate their trades for compliance.

“How are we going to do this with a reasonable amount of resources dedicated to this?” she asked.

Dealer groups are reflecting the concerns of individual firms. They are pressing the MSRB and the Securities and Exchange Commission to extend the compliance date, possibly by several months.

“I think the industry is still getting ready,” said Bond Dealers of America chief executive officer Mike Nicholas. “I think there’s still a long way to go in terms of getting ready for this.”

BDA has stressed the complexities of automating the waterfall process in past comments to the MSRB and SEC. Nicholas is concerned that the information firms end up providing on confirmations could wind up confusing customers.

“The last thing BDA members want is to create misleading information for retail investors,” Nicholas said.

Securities Industry and Financial Markets Association managing director and co-head of municipal securities Michael Decker said SIFMA is having discussions about these concerns with individual firms and with the regulators.

“The markup and PMP rules are complex,” Decker said. “In order to automate compliance, which is absolutely necessary for many firms, dealers will need to use sophisticated systems. Some firms are concerned that they will not have enough time to fully integrate and test their compliance systems by the deadline, especially if they’re going to depend on third-party vendors whose timelines are out of dealers’ control. SIFMA wants to ensure that the customer experience with the new confirm disclosure is a smooth as possible and we are actively discussing the obstacles to full readiness with our members and regulators.”

Vendors say they are confident in their products, but that the real challenge is in integrating their systems with the systems of individual dealer firms to ensure a smooth automated process from start to finish.

Tony Miscimarra, a managing director at BondWave, said he is “guardedly” certain his firm’s product is set to go because it has done thousands of trial runs with data provided by clients and potential clients. But only a tiny slice of the industry is even in the integration process yet, he said.

“Even those that are on the curve or even ahead of the curve now have to face implementation challenges,” Miscimarra said.

TMC Bonds CEO Thomas Vales said that because TMC runs an alternative trading platform, the infrastructure for providing a PMP solution is basically already in place, but Vales also expressed that integration is a heavy lift.

“Everyone is focused on what they need to do at hand, and then the last piece is going to be trying to integrate it with everyone else,” Vales said.

Miscimarra said an extension granted by regulators wouldn’t surprise him, but warned that firms can’t simply punt the problem down the road if they get one.

“That would be a big mistake,” he said.

The Bond Buyer

By Kyle Glazier

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