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Muni Brokerage Head Says Pricing Rules Won't Aid Mutual Funds.

- **'It's so much cheaper to pay a one-time charge on a bond'**
- **FMSbonds President Klotz says brokers not worried about rule**

On May 14, new rules will require brokerage firms to start disclosing some of the fees they charge individuals to buy and sell state and local government debt. Those fees, which firms build into the trades by marking the price up or down, averaged about 1.1 percent on investment-grade bonds in 2016, or $1,100 for a $100,000 bond, according to S&P Global.

Some analysts have speculated the new disclosures could accelerate a shift by individual investors toward mutual funds and other fee-based accounts. On average, long-term municipal bonds funds charged fees of 0.54 percent in 2016, according to the Investment Company Institute.

James Klotz, president of Boca Raton, Florida-based broker-dealer FMSbonds Inc., disputes that the disclosure of fees will have a big impact on behavior. He said individual investors, who tend to buy and hold municipal securities until they mature, are better off paying a one-time markup than annual fees to professionals to manage their portfolio.

Q: Why do you think individual investors will continue to buy individual bonds rather than shift to funds?

A: It's so much cheaper to pay a one-time charge on a bond an investor might hold 10, 15, 20, 30 years with no annual fees. Individual investors are buy and hold investors. They might get [bonds] called, they might sell them, but bonds aren't intended to be bought and sold every three months. They're bonds, not stocks.

Q: What's the average mark-up at FMSbonds?

A: I can tell you it's between 1% and 1.5% on a long-term bond. You have different situations. Bonds of a lesser quality may have more markup because of the risk.

Q: Isn't there some value to credit research that funds provide?

A: The percentage of defaults on investment grade bonds is less than 1%. 99.5 of 100 bonds are going to mature at par. That's history. There's no promise of face value when you invest in a mutual fund. Every bond dealer spends a great deal of money on research and on creditworthiness because that's our livelihood. If dealers were selling bonds that were defaulting, they wouldn't be in business very long. We've been in business since 1978.

Q: Are you worried about losing customers because of the markup disclosure rule?

A: No bond dealers are scared of this new rule. The only thing we're scared of is the instrumentation to be able to report it properly. Let's say I sell you a Boca Raton 4% bond at par at 10 a.m. and I'm looking at trades that came before me, they were all at par or a little premium. At 4 p.m., somebody does a trade at 98.5. What’s the prevailing price? That’s the difficulty. You can’t just think what preceded your price, you have to think what came after your price, that’s what’s going to make it difficult. All those trades have to be reviewed the following morning. We’re doing 300 trades a day. I don’t think the SEC understands how complex it is.

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