

# **Bond Case Briefs**

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## **SEC Examining Muni ATS', Broker's Brokers For Anti-Competitive Practices.**

WASHINGTON — The Securities and Exchange Commission is examining the extent to which dealers using alternative trading systems and broker's brokers are engaged in anti-competitive practices such as blocking or filtering out competitors from being able to bid on their municipal securities.

The SEC's Office of Compliance Inspections and Examinations has sent letters to the ATS', broker's brokers and dealers seeking trade information, sources said.

Thomas Vales, chief executive officer and chairman of TMC Bonds, formerly TheMuniCenter, an alternative or non-exchange, trading system for municipal bonds, confirmed that he received a letter from the SEC but declined to comment further.

Officials from the other two biggest muni ATS' — Tradeweb Direct, whose parent company is Tradeweb Markets, which acquired BondDesk Group in November, and KCG BondPoint, a division of KCG Americas, a subsidiary of KCG Holdings, Inc. — would not comment. SEC officials also would not discuss the letters or exams.

The exams may be a precursor to efforts by the SEC and Municipal Securities Rulemaking Board to get ATS' and broker's brokers to play a major role in improving muni price transparency.

In its report on the municipal securities market, released in July 2012, the SEC recommended it amend its Rule ATS, and the MSRB consider proposing rules, that would require ATS' and broker's brokers to publicly disseminate their best bid and offer prices. The report said they also should be required to disseminate, on a delayed and non-attributable basis, responses to "bids wanted" auctions. Ideally, the information would be posted on the MSRB's Electronic Municipal Market Access of EMMA system, which provides disclosure and trade data to retail investors and other market participants for free.

But any anti-competitive activity would skew the pricing information from ATS' and broker's brokers. The fewer the bids for a muni bond, the less likely the buyer will get the best price.

The SEC said ATS' and broker's brokers are key to pre-trade price transparency because they most often are used by dealers trying to buy munis for retail customers.

Retail investors who want to buy munis typically ask a dealer to identify bonds with credit, payment, tax, maturity or other characteristics that meet their needs, the SEC said in its report. A dealer may recommend munis from its own inventory or try to obtain munis from other dealers, through a broker's broker that brokers transactions between dealers, or through an ATS, an electronic trading platform that has participating dealers.

"To the extent there is pre-trade price transparency in the municipal securities market, the staff understands that it tends to be provided through electronic networks operated by broker's brokers,

ATS' or similar trading systems," the SEC report said.

These platforms account for a substantial portion of muni trades, but represent only a small percentage of dollar volume, which suggests they are used primarily for smaller-retail-size orders, the SEC said. Larger institutional trades tend to be executed through more traditional means, such as direct-voice negotiations with a muni dealer or voice brokerage and do not generate any pre-trade price transparency apart from the negotiation process, it said.

ATS' and broker's brokers tend to be 'inventory-based,' providing information only on the municipal securities their participating dealers would like to sell, and perhaps the prices sought (i.e. offers)," the SEC said. "Unlike a limit order book on an equities exchange or equity ATS, municipal securities ATS' typically provide no information on the participants who would like to buy or the prices at which they would be willing to do so (i.e. bids)."

### Legitimate Uses

Dealers sometimes block, screen or filter out other dealers for legitimate credit, regulatory or legal reasons. For example, a dealer putting out bids for bonds through an ATS might not want to sell to another dealer that historically doesn't follow through on its bid or has a bad reputation or legal issues.

But when a dealer merely wants to block other dealers from seeing its inventory and the munis it's offering, that's seen as anti-competitive.

The SEC noted these limitations in its muni report. The information from ATS' and broker's brokers is not widely accessible to the public for several reasons, the commission said. First, the trading interest reflected on these systems is generally only available to their participating municipal bond dealers and is not available or transparent to non-participants such as retail investors, it said. While some participating dealers may share information with certain customers, this is done solely at their discretion.

Second, these systems may allow participating dealers to limit the dissemination of their trading interests only to a subset of other muni bond dealer participants, the SEC said.

"For example, some ATS' permit a participant to apply filters so that their interest in a particular municipal security is conveyed only to its preferred trading partners," the commission said.

The MSRB raised similar concerns in interpretative guidance it issued in December 2012 on its Rule G-43 on broker's brokers and warned these firms that regulators will be on the lookout for anti-competitive practices.

The MSRB noted that G-43 "permits a broker's broker to limit the audience for a bid-wanted at the selling dealer's discretion, a practice sometimes referred to as 'screening' or 'filtering,' because the MSRB recognizes there may be legitimate reasons for this practice."

However, the MSRB noted, "such screening may reduce the likelihood that the high bid represents a fair and reasonable price" and warned, "Selling dealers should therefore be able to demonstrate a reason that is not anti-competitive (e.g., credit, legal, or regulatory concerns), rather than trying to eliminate access by a competitor, for directing broker's brokers to screen certain bidders from the receipt of bid-wanted or offerings."

The board suggested, as a compliance measure, that a selling dealer might want to maintain a list of firms it would be unwilling to accept as a counterparty and the reasons why.

## Broker's Brokers Consortium

Meanwhile, 10 broker's brokers have formed a consortium, called Municipal Bond Information Services, to provide pre-trade pricing information — offers and bids — on an anonymous basis to customers. Representatives of that group said they recently met with SEC officials to describe what they are doing and get some feedback.

Ron Valinoti, founder of Triangle Park Capital Markets Data, an information services company that is managing business operations for MBIS, said the group was incorporated in August, has been collecting pricing data for several weeks, and is currently lining up customers to sign contracts to take the data.

Valinoti says he expects customers will include: institutional investors; firms on the buy-side such as mutual funds, which must calculate net asset values on a daily basis; and firms that provide research services to retail investors either directly or through investment advisors, such as Morningstar and Yahoo Finance.

The trade data, which can be captured every five minutes and made available as often as every 30 minutes, can provide pricing transparency and be used to check information from pricing services or other sources, he said.

"We're trying to help address the concerns that were raised in the SEC's muni report to Congress. We're trying to take a proactive approach" by making pre-trade pricing information available, Valinoti said.

The broker's brokers in the group include: Associated Bond Brokers, Inc.; Butler Muni; Hartfield, Titus & Donnelly; RW Smith and Associates; Regional Brokers, Inc.; Sentinel Brokers Company, Inc.; Stark Municipal Brokers; Tradeweb Markets; Tradition Asiel (North America) Inc.; and Tullett Prebon Financial Services.

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