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MSRB Seen Requiring ATS Pre-Trade Price Disclosures.

FORT LAUDERDALE, Fla. — The Municipal Securities Rulemaking Board is likely in the future to propose requiring alternative trading systems to disclose to the board pre-trade price information on municipal securities, industry officials said after listening to speakers on a federal regulatory update panel at a conference here on Monday afternoon.

The industry officials said that Cynthia Friedlander, the director of fixed income regulation for the Financial Industry Regulatory Industry, who spoke on the panel at the National Municipal Bond Summit, "telegraphed" the future MSRB action, when she pointed out that FINRA and the MSRB have been working closely and coordinating on pre-trade price transparency initiatives.

FINRA has already proposed two such initiatives for corporate bonds and agency securities. The MSRB has followed by proposing one of those for munis and is likely to propose the other one for munis too, Friedlander indicated.

FINRA last year issued Regulatory Notice 14-52, which proposed requiring a dealer, for a same-day retail-size principal transaction in corporate or agencies securities, to disclose on the confirmation to a customer, the price to that customer, the price to the member firm of a transaction in the same security, and the differential between those two prices. The MSRB issued its own similar proposal for munis at the same time.

More recently FINRA issued Regulatory Notice 15-03, which proposed requiring ATS' to report to FINRA quotation information relating to corporate and agency securities. Under the proposal, dealers would have to identify the party that submitted the quotation information as well as the price of the quotation. ATS' match buyers and sellers for trades. Quotation information would include any offer to buy from or sell to any person or entity at a specified price, yield or spread, including any priced orders that may be displayed on behalf of a customer, according to the notice. FINRA is not proposing to make this information public, but is seeking public comments on that idea.

The MSRB has not yet made any public statements about this initiative. When asked about it by a reporter, Lynnette Kelly, the MSRB's executive director, noted that it was not in the speech she gave at the conference. But industry officials said they expect the board to follow up with its own similar proposal for munis.

Friedlander also said that FINRA, which has responsibility for examining dealer-municipal advisors, examined 80 of them last year and expects to examine a similar number of them this year. The self-regulator is looking at whether MAs are complying with registration, recordkeeping and supervisory rules, among other things, she said. While the Securities and Exchange Commission is responsible for examining non-dealer MAs, it may still question dealer-MA activities in its examinations of dealers, she cautioned those at the conference.

Friedlander said FINRA is trying to identify dealers that are engaging in MA activities without being aware of it. For example, she said, some dealers are not aware that if they recommend issuers invest bond proceeds in Treasuries or certificates of deposit, they become MAs subject to registration and

other MA requirements.

When questioned by the moderator of the federal regulatory update panel about reports that some issuers are hiring "paper [independent registered municipal advisors,] or IRMAs, so dealers that advise them on munis don't have to register as MAs, Jessica Kane, deputy director of the SEC's Office of Municipal Securities said the SEC would find that "extremely concerning" and that IRMAs must be meaningfully engaged. Friedlander said, "We'll be looking at whether the MAs are meaningfully engaged."

Friedlander also warned MAs to "be very careful with the documents you create on your fiduciary duty." The Dodd-Frank Act imposed a fiduciary duty on MAs to put their issuer clients' interests first, before their own. But Friedlander said FINRA has seen some dealer-MA documents that take a "mix and match approach" or are a "cut and paste of various documents" that contain provisions that are incompatible with fiduciary obligations. For example, if an MA says it has an arms-length relationship with an issuer for some activities, that would not be in line with its fiduciary duties. Underwriters have arms-length relationships with issuers, not MAs.

Kane warned that MAs that work for both an issuer, to whom they have a fiduciary duty, and a borrower, to whom they have no such duty, "should think very carefully about the disclosure of conflicts."

Similarly, on another panel on the evolving role of the MA, Dan Campbell, managing director of ACA Compliance Group, which helps muni market participants with compliance issues, said, "I can't over-emphasize enough that the concept of conflicts of interest is going to be a major issue for the SEC staff."

"That's something MA's need to think about," he said.

The MSRB is preparing to release a draft of Rule G-42 that would detail the kinds of conflicts of interest an MA should disclose to an issuer to comply with its fiduciary duty to that issuer. The draft will also cover other fiduciary requirements as well, such as the need for an MA to document its relationship with an issuer, and prohibitions on principal transactions, certain kinds of compensation and fees, and other MA activities, Kelly said in her speech at the conference.

During the panel on MAs, Marianne Edmonds, a senior managing director at Public Resources Advisory Group and MSRB board member, said some small issuers can only afford to hire an MA, or IRMA, on a contingent fee basis, under which the MA would get paid only if the transaction is completed. That is less expensive that hiring an MA on a monthly or indefinite basis. Edmonds noted that some people think such fees create a conflict of interest, but said she disagrees.

Those that worry about a conflict contend the fee structure could incentivize an MA to want to make a transaction work even if it's not in the issuer client's best interest.

Edmonds was worried about the fact that the an MA cannot become an IRMA in a transaction if the firm or one of its employees worked for the underwriter in a certain capacity or vice versa and the underwriter or one of its employees worked for the MA.

"We've struggled with that," Edmonds said. "This is something we have to think through and maybe talk to the SEC about. We don't want to discourage cross-pollination. I don't think it's to anyone's benefit to avoid crossing over."

Lourdes Reyes Abadin, an executive vice president at Estrada Hinojosa & Co, pointed out that during the financial crisis in 2008 and 2009, "You had a hard time figuring out who was working for

whom."

But Kane, at the later panel, said it is only a two-year look-back. "It's a two-year cooling off process," she said and after that entities and individuals "can be screened off" the prohibition.

The MA rule generally exempts engineers, lawyers and certain other market participants from being MAs, but Edmonds and Campbell were aware of situations in which an engineer and an environmental consultant wrote reports that had recommendations that, had they been given to the issuer, would have forced the engineer or environmental consultant to register as MAs.

Most of the panelists said the market has generally adjusted to the MA rules. "There was a lot of concern that this was going to stop communication in its tracks. We really have not seen that," said Edmonds.

"I think the confusion level has gone down somewhat," said Campbell.

But the rules have led to changes. Abadin said her small dealer firm used to try to gain a "competitive edge" by presenting financing ideas to issuers. "That is no longer an acceptable avenue for us," she said.

Abadin also noted her firm's compliance department has grown from one to three individuals.

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