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Shining A Light On Municipal Bond Markups.

Transparency is an overused word that is rarely executed—especially in the bond market. Think about how long it took regulators to require that bond desks post trade prices, and amounts purchased and sold. Years. All the while bond dealers squirmed, kicked and screamed, claiming it would destroy the debt market. Today, the bond market is alive and well—even with electronic pricing.

The Municipal Securities Rulemaking Board (MSRB) is currently proposing that bond dealers acting as principals fully disclose their markup or markdown to retail customers. That's right. When you purchase or sell a municipal bond your confirmation prints the trade profit your broker took. The industry calls this the spread. Details of this proposal are still evolving.

Here's how The Bond Buyer describes it:

“Under the markup proposal, a dealer buying or selling bonds for its own inventory would be required to disclose the markup or markdown on a customer's confirmation when: it executes a transaction on the same side of the market as the customer; the transaction is greater than or equal to the size of the customer's; and the dealer transaction occurs within a two-hours window on either side of the customer transaction.

Those markups and markdowns would be equal to the ‘difference between the price to the customer and the prevailing market price for the security,’ and would have to be disclosed both as a total dollar amount and as a percentage of the principal amount of the customer transaction.”

I have one word to express my glee if this rule passes: Whoopie! That is because for years investors never knew what their broker was earning on their municipal bond trades. Certainly they could go to the emma.msrb.org Web site. And for those few who utilize the Web site, it's not clear for actively traded issues whose 25,000 or 50,000 trade actually belonged to whom. If this new rule goes into effect there will be no second-guessing—the telltale information will be right on the investor confirmation.

The SEC has said it wants more transparent markup and markdown disclosure. I couldn't agree more. Finally, investors will know if their broker or the Web site they point and click on is being fair or egregiously piggy.

Count on one thing: the brokerage industry will kick and scream, negotiate and whine, stomp and cry while trying to delay its implementation. In my opinion, the rule will be implemented. Small investors will be the biggest beneficiaries. Brokers and their firms will have no choice but to take less of your hard-earned investment dollars.

FORBES

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