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U.S. Muni Bond Firms Race to Comply with New Price Transparency Rule.

NEW YORK, May 10 (Reuters) – U.S. municipal bond firms are rushing to comply with a new mandate taking effect on Monday that will force brokers for the first time to disclose how much they charge individual investors on some trades in the tax-exempt debt market.

The so-called markup disclosure rule is aimed at adding transparency to a $3.8 trillion market where the debt of states, local governments, hospitals, universities is traded though an opaque network of dealers as opposed to a central exchange.

"Everyone has been racing towards this deadline," said Michael Ruvo, president of Wheaton, Illinois-based BondWave, which focuses on fixed income analytics and other services for the financial services industry.

Dealers will now be required to disclose fees, known as markups for selling and markdowns for buying muni bonds, to retail customers, who owned $1.57 trillion of the debt last year.

The rule was first proposed by the Municipal Securities Rulemaking Board, the muni market's self regulator, in September 2016 and approved by the U.S. Securities and Exchange Commission later that year.

Trading in some corporate bonds, under an amendment to Financial Industry Regulatory Authority rules, will also be affected.

Under the rule, muni brokers will be required to determine a baseline number, known as a "prevailing market price," in order to show retail investors how much prices for a bond transaction were marked up or down.

With just days left before the rule is rolled out, Ruvo said he is receiving last-minute calls from clients requesting help with the calculation models to determine those prices among other needs related to the rule change.

The process of determining prevailing market prices for individual muni bonds can be particularly arduous because of the diverse, vast and sparsely traded nature of the market in comparison to U.S. Treasuries or equity markets, said Jeffrey MacDonald, head of fixed income strategies for Fiduciary Trust Company International in New York.

Smaller broker-dealers may find it especially challenging to get their systems into compliance by the deadline, MacDonald said. The new rule could also make brokers cautious about adding cost to investors, he said.

Those difficulties, along with heightened investor awareness of the costs, could lead to a shift in the market, analysts said.

Over the longer-term, individual investors could opt to replace their direct muni bond holdings with professionally managed portfolios, such as mutual funds or separately managed accounts (SMA).

“If SMA assets start to grow at an even faster pace as a result of the mark-up rule, we might see demand for 5-10 (year) paper increase, as this part of the curve is preferred by SMAs,” Barclays municipal credit analyst Mikhail Foux said in a recent research note. That, in turn, would lead to a steepening yield curve, he added.

Financial advisers for investors, who sometimes buy individual bonds for clients, could also turn to larger investment management firms to handle those transactions due, in part, to the added burden of the new pricing disclosure rule, said Dawn Daggy-Mangerson, director of the muni bond team at McDonnell Investment Management in Oakbrook Terrace, Illinois.

The next step will be explaining and defending the number to investors.

by Laila Kearney

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