TREASURY | PARTNERS

Alert

A Ray of Sunshine in Munis

April 30, 2018

Richard Saperstein
Managing Director/Principal
+1 917-286-2777
rsaperstein@treasurypartners.com

Steven Feit
Managing Director
+1 917-286-2793
sfeit@treasurypartners.com

Daniel Beniak, CFA
Director
+1 917-286-2783
dbeniak@treasurypartners.com

treasurypartners.com

We're on the cusp of an important pro-investor milestone in the world of municipal market transparency. As of May 14th, a new regulatory rule will require brokers to reveal any markups they've built into the price of certain muni bond sales to retail clients.

For background, "markups" on municipal bonds are hidden, often-inflated commissions included in retail muni bond trades. Brokers operate on a "suitability" standard and are free to layer in an extra commission charge into the price of small-size muni bond sales to their retail clients.

Refresher: Professional Obligations to Clients

There are two broad standards of conduct for financial professionals:

- **Suitability.** The weaker of the two standards. It requires only a "reasonable basis" behind any investment advice. This is the standard which brokers and non-fiduciaries typically follow, and does not mandate prioritizing the client's interests.
- **Fiduciary Standard.** The stronger of the two standards. It requires advisors to go above and beyond the Suitability standard and ensure that any advice is not just "reasonable," but also prioritizes the client's interests above those of the advisor's. It's also commonly referred to as the "Best Interests" standard.

Treasury Partners is a Registered Investment Advisor associate which operates under a fiduciary standard.

Markups increase the price of a bond, and since bond prices and yields have an inverse relationship, this means they decrease the bond's yield for the purchaser. Many sources estimate the typical muni retail markup is over 1% of the bond's price, which can greatly reduce an investor's return. Even worse, markups are nearly always hidden and are in addition to any fees being charged for managing the overall portfolio!

Markups in Action

Here's a demonstration of the impact of a markup on a representative, "plain vanilla" short-term municipal bond. We recently saw an offering for a AA-rated national muni maturing in 5 years.* At the time, the fair market price for this bond was approximately $110.9, which translated to a yield of 2.13% (78% of the equivalent Treasury yield).

Now assume that a broker sells this bond to a retail investor a with a 1% markup – that is, the price the investor must pay increases from $110.9 to $112. While it doesn't seem like a big difference, appearances can be deceiving – the investor's yield has now declined 0.27% to just 1.86% (68% of the equivalent Treasury yield).

Fair Market Price *BEFORE* Markup	Fair Market Yield *BEFORE* Markup	Price Increase from 1% Markup	Price *AFTER* Markup	Yield *AFTER* Markup
$110.9	2.13%	$1.11	$112.0	1.86%

**Example bond is CUSIP 736742ZA8 – City of Portland, Oregon Second Lien Sewer System Revenue Bonds, Rated Aa2/AA-, 5.00% Coupon, Final Maturity 5/1/2022. Assumed pricing based on trading data and estimated fair market values as of 4/27/18.*

Importantly, the new rule is not perfect as some retail muni sales will be still exempt from the markup reporting requirement. However, since munis are one of the last "major" asset classes where hidden retail markups are fairly common, it's still a positive change.

As Registered Investment Advisor associates who operate under the strict fiduciary standard, Treasury Partners is ***not*** impacted by this new rule: we always put the best interests of our clients first. We ***never*** "double dip" and markup client bonds – the transaction prices in our client accounts always reflect true market levels - ***and our only fees are regularly and transparently disclosed to you***. Moreover:

- Whenever possible, we attempt to capture favorable institutional-level pricing in trading directly with major banks and dealers
- We are obligated to transact under best-efforts for most favorable pricing in the marketplace

This is a landmark ray of sunshine for the muni market. While it will have zero impact on our activities, it will add transparency for anyone buying bonds through brokers and other non-fiduciaries.

Here's a link to a recent Bloomberg News with additional information on this topic. As always, please feel free to reach out to us with any questions.