

Time of Trade Disclosure: Potential Exposures that Many Have Not Considered

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Recently, the MSRB and FINRA provided reminders regarding the municipal market's time of trade disclosure rule (MSRB Rule G-47). The MSRB, by way of a Regulatory Notice, reminded market participants that a "Market Discount" is material and needs to be disclosed (read MSRB notice [here](#)) and, in the case of FINRA, findings of violations of failure to disclose, at or before the time of trade, amounts below minimum denominations and that the bonds contained a resale restriction that could impact liquidity (see FINRA actions [here](#) and a Bond Buyer article on the subject [here](#)).

In a recent discussion with market participants, we were reminded of other material information that is reasonably accessible that should be disclosed at or before the time of trade. Namely, a firm's knowledge of a failure to make filings under a continuing disclosure agreement. As we know, this is a current area of focus for the SEC. In this article, we will review the applicable time of trade disclosure rule and, by way of an example, identify two scenarios that warrant disclosure to retail and non-SMMP investors.

MSRB Rule G-47 provides that:

No broker, dealer, or municipal securities dealer shall sell a municipal security to a customer, or purchase a municipal security from a customer, whether unsolicited or recommended, and whether in a primary offering or secondary market transaction, without disclosing to the customer, orally or in writing, at or prior to the time of trade, all material information known about the transaction, as well as material information about the security that is reasonably accessible to the market.

Thus, material information known, and that is reasonably accessible, must be disclosed to the retail and non-SMMP investor at, or before, the time of trade. The challenging aspects for our discussion participants became twofold:

- Is information the firm becomes aware of during its underwriting of a new issue material?
- If yes, is the firm required to disseminate that information to those interfacing with retail and non-SMMP?

Let's start with an example to help guide us through these questions:

Broker-dealer "Potter" underwrites municipal securities and has a network of retail-facing brokers. Potter underwrites a new issue for Hogwarts and discovers that Hogwarts has (i) failed to file several required disclosures, (ii) initially did not disclose the same in the POS for the new issue and (iii) did not make the disclosure in the final OS after being requested to do so by Potter. After performing their diligence, Potter concluded that, because of the missed filings, lack of disclosure and lack of confidence that Hogwarts will comply prospectively, it would not bid this new issue.

Is information the firm becomes aware of during its underwriting of a new issue material? Specifically:

- *Disclosing Missed Continuing Disclosure Filings*
- *Disclosing Assessment of Prospective Continuing Disclosure Compliance?*

This discussion point was broken down to two potential exposures. First, if Potter learned of missed continuing disclosures during its underwriting of Hogwarts, is the same material? The group quickly pointed to the Supplementary Material to G-47 which provides a non-exhaustive list of disclosure obligations and specifically includes:

Failure to make continuing disclosure filings. Discovery that an issuer has failed to make filings required under its continuing disclosure agreements. MSRB Rule G-47, Supplementary Material .03, o.

The group concluded that if Potter had *knowledge* of a failure to file a filing required under Hogwarts' CDA the same was material and must be disclosed at or before the time of trade to their retail and non-SMMP investors.

The group turned to the second potential exposure -- "is Potter's decision not to bid the Hogwarts' new issue due to poor disclosure history and lack of confidence in Hogwarts' ability to comply prospectively material information?"

Several in the group took the view that the decision not to underwrite due to poor disclosure history and lack of confidence in Hogwarts' ability to comply with their obligations was material while other participants voiced skepticism. The group, however, agreed that, given the heightened focus on protection of the retail investor and meeting disclosure obligations, it would be prudent to treat this information as material.

Is Potter required to disclose to retail and non-SMMP investors this "material information" it learned by participating in the underwriting of Hogwarts?

Returning to G-47 and the Supplementary Material:

Processes and Procedures. Brokers, dealers, and municipal securities dealers must implement processes and procedures reasonably designed to ensure that material information regarding municipal securities is disseminated to registered representatives who are engaged in sales to and purchases from a customer. MSRB Rule G-47, Supplementary Material .04. (*Emphasis Supplied*)

In our example, Potter (the broker-dealer) is aware of material information. The Supplementary Material to G-47 makes clear that it needs to have procedures reasonably designed to ensure that the material information gets to their registered representatives. Potter's registered representatives, must ensure they disclose the same to the retail and non-SMMP investor.

Our discussion turned to how one ensures that information a firm learns during its underwriting of a new issue is properly identified and communicated internally to meet its obligation to disclose material information at or before the time of trade to retail and non-SMMP investors. A discussion ensued about technology that enables this task to be accomplished easily during the underwriting process whereby

the underwriter's observations and conclusions can be easily tagged to all outstanding bonds for that issuer thereby ensuring the "material information" is disseminated to the registered representative for their communication to the retail and non-SMMP investor.

For broker dealers engaged in the purchase and sale of municipal securities from/to retail and non-SMMP clients, the question is "are they aware of all of the material information about the bond that is reasonably accessible and in the hands of their firm?" In this regard, the heightened focus on protection of the retail investor and disclosure overall may present an additional requirement for broker-dealers that many have not considered – the disclosure of what your underwriter concludes regarding an issuer's compliance with prior continuing disclosure obligations and their assessment of whether that issuer will comply prospectively.

Based on discussions with market participants, the above issue may be an exposure for many broker-dealers. We encourage you to review existing policies and procedures around disclosure to contemplate how to address this scenario. While new regulations and the enforcement of new and existing rules and regulations have created a burden on many, the use of technology can be an efficient solution.

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