

November 13, 2018

Submitted Electronically

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1300 I Street NW
Washington, DC 20005

RE: Request for Comment on Draft Interpretive Guidance on Pennying and Draft Amendments to Existing Guidance on Best Execution

Dear Mr. Smith:

On behalf of the Bond Dealers of America (“BDA”), I am pleased to submit this letter in response to the MSRB’s Notice 2018-22 (the “Notice”): Request for Comment on Draft Interpretive Guidance on Pennying and Draft Amendments to Existing Guidance on Best Execution. The BDA is the only DC-based group representing the interests of securities dealers and banks exclusively focused on the U.S. fixed income markets. We welcome this opportunity to present our comments.

General Comments

To begin, members of the BDA want to acknowledge that they are familiar with the somewhat common practice of “pennying” as generally defined in the Notice but believe that a narrowing of the definition would benefit the marketplace should the MSRB seek to provide interpretive guidance in this regard. Our members believe that the MSRB is erroneously conflating numerous practices in the municipal securities market under the rubric of “pennying,” and should limit their focus to a singular problematic practice of “pennying” as defined by our members below.

The BDA advises the MSRB to be cautious when considering comments from certain market participants who assert that the “highest bid” on a bid wanted situation should *always* prevail in the sale of municipal securities. There are legitimate reasons regarding why this may not be the most appropriate course of action. For example, dealers often purchase municipal securities following a bid wanted auction because the dealer believes the bids do not accurately reflect a fair price for those municipal securities. For this and other reasons, the BDA believes that it is critical that any MSRB guidance concerning “pennying” narrowly address the specific abusive practice and not attempt in this effort to address the concern of low trade fulfillment rate or overall market liquidity.

Specific Questions regarding “Pennyning”

- *What is “Pennyning”?*

The BDA believes that “pennyning” is the practice and pattern of a dealer to engage in a systematic business strategy to use bids wanteds for price discovery with the intent to purchase the municipal securities at a nominally higher price over the cover bids. We believe that the combination of the bid data and the MSRB trade data clearly identifies which dealers are engaged in this abusive practice as some dealers engage in “pennyning” on a daily basis. Thus, the *intention* of the dealer is inherent to the definition of “pennyning” and it is this practice that is concerning for the market place.

- *Is “pennyning” Common?*

The BDA membership does encounter the practice of “pennyning” (as we define above) frequently and agrees that this practice is troublesome. The BDA supports the efforts of the MSRB to clarify that the practice (as we define it above) is a violation of MSRB Rule G-17.

- *Does “pennyning” impair liquidity in the municipal securities market?*

Although the BDA does not have any empirical data to prove this point, we do believe that “pennyning” may impact the confidence of bidding dealers overall and their willingness to participate in bid wanted auctions. As such, the practice of “pennyning” potentially contributes to low execution or fulfillment rates and thus compromises a successful auction. Most importantly, dealers who engage in “pennyning” frequently impair their ability to fulfill their own customer bid wanted requests as electronic trading platforms often times disclose a dealer’s trade fulfillment rate. Increasingly, the market can identify which dealers consistently engage in “pennyning” and avoid auctions initiated by those dealers. Accordingly, the BDA believes that “pennyning” probably does impact liquidity in the municipal securities market.

- *Does the proposed interpretative guidance appropriately address “pennyning”?*

The BDA supports the MSRB’s efforts in adopting an interpretative release that would address the practice of “pennyning” as we have defined. However, the BDA believes that the proposed interpretative release focuses too much on the use of bids wanted for price discovery purposes and not enough regarding the identified business strategy and practice of a dealer that participates in “pennyning.” Considering the requirements of MSRB Rule G-18, the BDA believes that it could be unclear for market participants if the focus remains on price discovery alone. As discuss above, the bid data and MSRB trade data clearly reveal who may be engaged in this practice and thus any interpretative guidance should be clearly focused on the *systematic* nature of the dealer behavior as an element of “pennyning.”

- *The BDA strongly believes the MSRB should not adopt a rule to prohibit “pennyning”.*

The BDA believes that a release of interpretative guidance under Rule G-17 would be the best vehicle to address this practice. As alluded throughout the Notice, the MSRB is going to be challenged to accurately define “pennyning” in any rulemaking effort. An interpretative guidance

affords the MSRB the ability to identify “pennying” under the fair dealing principles of Rule G-17 and will be thus easier to capture the more qualitative and intent-based elements of “pennying.” The BDA recommends that the MSRB avoids creating a concrete definition of “pennying” as the fact pattern is usually clear when it actually occurs.

- *Should the MSRB provide a safe harbor or some other guidance concerning blind bids by dealers?*

The BDA believes that a safe harbor for dealers bidding in auctions could be helpful if the MSRB makes clear that such safe harbor is not the only option to avoid violating Rule G-17. Many dealers purchase municipal securities following an auction for which they did not participate for altogether legitimate reasons. Often times it is the customer itself that refuses to sell its security at the high bid price resulting from an auction and thus the dealer’s purchase of the security at a nominally higher price is done to accommodate their customer. Therefore, the BDA cautions the MSRB not to discourage these legitimate practices even if they may impact overall trade fulfillment rates. The BDA further recommends the MSRB be clear in guidance that dealers who participate in their own bid auctions and then purchase the security at a nominally higher bid, is not necessarily engaging in “pennying”.

- *What is the appropriate balance between complying with best execution requirements and avoiding “pennying”?*

The BDA believes that the difference between compliance with Rule G-18 and “pennying” comes down to the business approach a dealer takes with respect to the purchase of municipal securities from its customers. Where a dealer routinely uses a bids wanted process to determine in good faith that it is obtaining a favorable price for customers, that is the heart of compliance with Rule G-18. Where a dealer, however, routinely uses a bid wanted process with the *intention* to purchase all of the municipal securities of its customers, or for certain kinds or categories of municipal securities of its customers, the BDA believes that the bids wanted process may merely be a manner by which a dealer can comply with Rule G-18 while still being able to engage in a systematic business strategy of “pennying”. This latter practice the BDA believes is not a legitimate means by which a dealer complies with Rule G-18.

In regard to the second set of questions in the Notice (starting on page 8), the BDA agrees that posting bids wanted on multiple trading platforms is not a necessary component of compliance with MSRB Rule G-18. However, the BDA does believe that there are good and legitimate reasons for a dealer to post bids wanted on multiple trading platforms. Where a dealer may have concerns regarding what kinds of bids it may receive on any given trading platform, a dealer may want more visibility for the bids wanted. Often times, though, the BDA believes that dealers post bids wanted on multiple trading platforms out of a regulatory concern (G-18). Accordingly, the BDA believes that it is important for the MSRB to be very clear that a dealer does not need to post bids wanted on multiple platforms.

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If you or your staff has any questions or need additional information, please do not hesitate contact me directly at 202.204.7901 or mnicholas@bdamerica.org. We look forward to your response.

Sincerely,

A handwritten signature in blue ink that reads "M. Nicholas". The signature is fluid and cursive, with the first name "M." and the last name "Nicholas" clearly visible.

Michael Nicholas
Chief Executive Officer
Bond Dealers of America