



March 6, 2019

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1300 I Street NW
Suite 1000
Washington, DC 20005

Re: MSRB Notice 2019-01: Request for Comment on Draft Interpretive Guidance on Application of MSRB Rules to Certain Prearranged Trading in Connection with Primary Offerings

Dear Mr. Smith:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates this opportunity to respond to Notice 2019-01 (the “Notice”)² issued by the Municipal Securities Rulemaking Board (the “MSRB”) in which the MSRB is requesting comment on draft interpretive guidance on application of MSRB rules and prior interpretive guidance to certain prearranged trading in connection with primary offerings of municipal securities.

I. MSRB Should Defer Action on the Notice

In light of ongoing Securities and Exchange Commission (“SEC”) examination and enforcement activity with respect to these issues, some SIFMA members are not in a position to participate in the comment process on this subject at this time. Therefore, we respectfully, yet strongly, request the MSRB withdraw the request for comment or

¹ SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry’s nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>. SIFMA letters present a consensus view of its members. Due to the variety of views on this issue, this letter does not reflect the individual views of every member.

² MSRB Notice 2019-01 (January 3, 2019).

otherwise defer proceeding on any related guidance or rulemaking until the SEC concludes its enforcement activity in this area.

II. Rule G-17 – Fair dealing

MSRB Rule G-17 states, “In the conduct of its municipal securities or municipal advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.” SIFMA members feel this rule is critical for market participants to have trust and confidence in the municipal securities market. SIFMA and its members also believe that vigorous enforcement of the MSRB’s rules is critical to ensuring rule compliance and the removal of any bad actors. The deliberate mischaracterization of the nature of an order by a syndicate member is clearly behavior that violates MSRB Rule G-17. To this end, it should be made clear that scienter is a necessary element of the rule violation.

MSRB Rule G-17, which imposes a fair dealing duty upon regulated broker dealers, assumedly is not limitless. The MSRB has never articulated its applicability with respect to non-syndicate members or investors during retail order periods. Current MSRB Rule G-17 guidance states that underwriters should not disregard issuers’ rules for retail order periods by accepting or placing an order that does not satisfy an issuers’ definition of retail, such as knowingly accepting an order framed as a retail order when it is not.³ There has been significant industry debate as to whether the guidance in the Notice, which the MSRB characterized as a reminder of existing requirements, results in a significant extension of the existing guidance. This debate, in and of itself, is telling that the position set forth in the Notice by the MSRB was not understood or appreciated by all industry members to reflect the current requirements. In light of that, SIFMA requests that if the MSRB proceeds with guidance in this area, that they clearly state a prospective effective date for such new guidance. Regulated broker dealers understand the need and ability of the MSRB to make new rules or broaden existing guidance, as long as appropriate notice is given as to when such new rules will be effective. The concern in this instance is the characterization of this guidance as a reminder of existing requirements, which could have significant implications for all dealers. Retroactive rulemaking, or even the perception thereof, is not considered fair regulation.

SIFMA notes that a non-syndicate member dealer is not in privity of contract with and has no direct duties to the issuer. Issuer restrictions are agreed to by syndicate members that are in privity of contract with the issuer during the underwriting period. A non-syndicate dealer is, on the other hand, in privity of contract with its own customers. If a non-syndicate dealer were to convince a customer to serve as an intermediary for a non-syndicate dealer order, and agree to purchase the bonds from the customer in the secondary market at a set price or spread prior to the time that the bonds

³ MSRB Notice 2012-25 (May 7, 2012).

begin to trade in the secondary market, there may or may not be a violation of MSRB Rule G-17 by the non-syndicate member; although, the necessary scienter would need to be clear for a violation to be proven relative to any deceptive, dishonest, or unfair practice.⁴

III. Scope of Rule G-11 – Primary Offering Practices and Legitimate Secondary Market Trading

In a primary offering of bonds, brokers, dealers and municipal securities dealers (collectively, “dealers”), make a public offering of the bonds and take indications of interest, orders or make conditional trading commitments.⁵ Oftentimes, it is normal for prices to trade up in the secondary market as the securities make their way through distribution channels into the hands of investors. Dealers are in the business of making markets in securities, and it is appropriate and expected that they make it known to other dealers and investors if such dealer is interested in transacting in particular securities. As stated in the Notice:

[T]he draft guidance is not intended to preclude dealers outside of a syndicate or selling group from entering orders with syndicate/selling group members and purchasing bonds for their own accounts in accordance with priority provisions established by the syndicate, or to limit communications between dealers and investors regarding new issues, which are not for the purpose of evading applicable MSRB rules. Finally, the draft guidance is not intended to preclude dealers or investors from purchasing bonds in a new issue, without the use of a prearranged trade, and then selling them in the secondary market shortly thereafter, or to otherwise discourage ordinary secondary market trading.

The activities the MSRB lists are all permissible, and critical to normal and fair market operations.

SIFMA members feel it is important to ensure that lead underwriters can reasonably rely on the representations of co-managers regarding the characterization of orders in a primary offering. Also, it should be clear that a dealer expressing interest in transacting in particular bonds is normal market activity.

⁴ So long as it does not constitute a prohibited guarantee or sharing of accounts under Rule G-25.

⁵ In a primary offering, the bonds at issue do not exist until the signing of the bond purchase agreement or competitive award of the bonds. Prior to that time, no trades can be entered into or processed in the MSRB’s Real-time Transaction Reporting System. To gauge interest in a particular bond, dealers solicit indications of interest and may enter into conditional trading commitments, which are conditional agreements to trade if the bond purchase agreement is signed or award of the bonds is completed.

The term “pre-arranged trade” is not defined, and the term can easily be confused with the permitted activities described above. Specifically, the term “arranged” is not a clearly defined. Further, it should be made clear that the impermissible activity is the intentional misrepresentation of the order submitted by a syndicate member to unjustly obtain a higher order priority, such as mischaracterizing the order as a retail order and/or misrepresenting the client’s place of residence, or a misrepresentation of the order to attempt to enter into an impermissible profit-sharing arrangement with an investor. SIFMA and its members believe that an actual misrepresentation necessitates an improper agreement. In sum, SIFMA members want to ensure that the guidance is clarified so that the normal process of a primary offering, and legitimate secondary market trading, and sharing of market color, is protected. SIFMA’s goal is to ensure that the rules and guidance are clear and effective in prohibiting improper behavior, but not unduly burdensome so as to hamper the proper functioning of the market.

IV. Scenarios

A. Scenario 1 – Prearranged Trade with a Member of the Syndicate of Selling Group

SIFMA and its members have a number of concerns regarding the first Scenario. SIFMA members would like the MSRB to clarify that scienter, or the intent to misrepresent the order by the syndicate/selling group member, is foundational to the analysis and a necessary element for a potential violation of the rule. To prove collusion with the non-syndicate/selling group dealer, both the syndicate member and the non-syndicate member would need to exhibit the intent to misrepresent the order. Simply soliciting or providing indications of interest, providing market color on a particular bond, or putting in an order at list price surely does not constitute prohibited pre-arranged trading. Further, if a syndicate member put in an order for stock, but decided after the bonds were “free to trade” to trade the bonds to a non-syndicate member, that should not be prohibited absent any intentional misrepresentation.

B. Scenario 2 – Prearranged Trade with an Investor

In the second Scenario, it is important to note that the investor is controlled neither by the rules governing the syndicate nor by the MSRB rules. With respect to investors, it is also important to note that there are no “lock up” or holding provisions that restrict investors selling bonds they own to any market participant. Any such restrictions would be a restraint of trading activity, and if imposed, would have implications on pricing levels. Investors may sell bonds they own at any time, which is a key component to market liquidity. The MSRB itself has already addressed this point, noting in a 2013 letter to the SEC that “it is not a goal of [Rule G-11(k)] to prescribe a holding period” for

retail order period participants and that it had not been determined “whether such a requirement would be consistent with the promotion of a free and efficient market.”⁶

Again, SIFMA believes that to show a violation of MSRB Rule G-17, the intent of the dealer to misrepresent the nature of the order submitted by a syndicate member must be proven. If a non-syndicate member gives an order to a syndicate member for stock at the list offering price, that order itself is not problematic. The rule violation is triggered not by the order itself, but by an intentional misrepresentation or mischaracterization of the type of order.

V. Free to Trade Wire

SIFMA members note that only syndicate members receive wire notification of when bonds are “free to trade” pursuant to the agreement among underwriters governing the syndicate. Other industry members typically do not receive any communications as to when bonds are “free to trade”, and it is not clear to parties outside the syndicate as to when the syndicate restrictions have been lifted.

VI. Conclusion

SIFMA and its members reiterates its call for the MSRB to withdraw the Notice, or otherwise defer proceeding on any related guidance or rulemaking until the SEC concludes its enforcement activity in this area. Absent that result, SIFMA and its members are available discuss any of these comments in greater detail, or to

⁶ Letter from MSRB Deputy General Counsel, Michael Post, to SEC Secretary, Elizabeth Murphy (Sept. 6, 2013), at 5, available at <https://www.sec.gov/comments/sr-msrb-2013-05/msrb201305010.pdf>.

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Corporate Secretary
Municipal Securities Rulemaking Board
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provide any other assistance that would be helpful. If you have any questions, please do not hesitate to contact me at (212) 313-1130.

Sincerely yours,

A handwritten signature in black ink, appearing to be 'L. Norwood', written in a cursive style.

Leslie M. Norwood
Managing Director and
Associate General Counsel

cc: ***Municipal Securities Rulemaking Board***
Lynnette Kelly, President and Chief Executive Officer
Michael Post, General Counsel
Lanny Schwartz, Chief Regulatory Officer
John Bagley, Chief Market Structure Officer