



May 3, 2012

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Response to Comments on File No. SR-MSRB-2012-04

Dear Ms. Murphy:

On March 5, 2012, the Municipal Securities Rulemaking Board (the “MSRB”) filed with the Securities and Exchange Commission (the “Commission”) a proposed rule change consisting of (i) proposed MSRB Rule G-43 governing the municipal securities activities of broker’s brokers and certain alternative trading systems (“Proposed Rule G-43”), (ii) proposed amendments to MSRB Rule G-8 (on recordkeeping by broker’s brokers and certain alternative trading systems), MSRB Rule G-9 (on record retention), and MSRB Rule G-18 (on agency trades and trades by broker’s brokers) (collectively, the “Proposed Amendments”); and (iii) a proposed interpretive notice on the duties of brokers, dealers, and municipal securities dealers (“dealers”) that use the services of broker’s brokers (the “Proposed Notice”). The proposed rule change was published by the Commission for comment in the Federal Register on March 26, 2012, and the Commission received five responses.¹ This letter provides the MSRB’s responses to these comments.

Proposed Rule G-43(a)(iii) -- Representative of Seller. Proposed Rule G-43(a)(iii) would provide, “A broker’s broker will be presumed to act for or on behalf of the seller in a bid-wanted for municipal securities, unless both the seller and bidders agree otherwise in writing in advance of the bid-wanted.”

BDA said that this presumption may discourage potential buyers from bidding and reduce liquidity in the municipal securities market. BDA offered no rationale for this statement, and the MSRB disagrees with BDA’s comment. Many broker’s brokers require their clients,

¹ See Exchange Act Release No. 66625 (March 20, 2012), 77 FR 17548 (March 26, 2012). Comments were received from Advisors Asset Management (“AAM”); Bond Dealers of America (“BDA”); Hartfield, Titus & Donnelly (“Hartfield, Titus”); R.W. Smith & Associates, Inc. (“R.W. Smith”); and TMC Bonds, L.L.C. (“TMC Bonds”).

including dealers, to sign agreements prior to effecting trades through them. If a broker's broker were to wish to represent bidders as well as sellers in bid-wanted, it could simply include a clause in such agreement. Sellers and bidders could then decide whether they were willing to execute the agreement and, thereby, agree to dual representation.

Proposed Rule G-43(b) -- Predetermined Parameters. Proposed Rule G-43(a)(i) would provide, "Each dealer acting as a 'broker's broker' with respect to the execution of a transaction in municipal securities for or on behalf of another dealer shall make a reasonable effort to obtain a price for the dealer that is fair and reasonable in relation to prevailing market conditions." Proposed Rule G-43(b) would provide that a broker's broker would satisfy the pricing obligation of Proposed Rule G-43(a)(i) if it followed the safe harbor of Proposed Rule G-43(b). Proposed Rule G-43(c)(i)(F) would provide that, "if the broker's broker wishes to conduct a bid-wanted in accordance with [the safe harbor], [its policies and procedures must] require the broker's broker to adopt predetermined parameters for such bid-wanted, disclose such predetermined parameters prominently on its website in advance of the bid-wanted in which they are used, and periodically test such predetermined parameters to determine whether they have identified most bids that did not represent the fair market value of municipal securities that were the subject of bid-wanted to which the predetermined parameters were applied. The Proposed Notice would provide examples of ways in which broker's brokers could establish such predetermined parameters: "yield curves, pricing services, recent trades reported to the MSRB's RTRS System, or bids received by broker's brokers in prior bid-wanted or offerings."

Two commenters objected to the predetermined parameters portion of the safe harbor. BDA said that the safe harbor was based on the premise that it was the obligation of a broker's broker to determine what is a fair price or, at least, a range of fair prices. BDA did not agree with that premise. The MSRB reiterates that existing MSRB Rule G-18 already requires broker's brokers to "make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions." The MSRB has simply proposed to move that same pricing obligation into Proposed Rule G-43(a)(i). The proposed rule does not adopt the stricter pricing obligation that is found in MSRB Rule G-30, which prohibits brokers, dealers, and municipal securities dealers ("dealers") from purchasing or selling municipal securities to customers as principals at prices that are not fair and reasonable. We note, however, that, in its municipal securities transactions with customers (as defined in MSRB Rule D-9) as a principal, a broker's broker is subject to Rule G-30.

BDA also said that, in times of volatile markets, many bids could be outside a broker's brokers predetermined parameters and that the broker's broker could be required to contact numerous bidders or sellers. The MSRB notes that the safe harbor is completely optional. Proposed Rule G-43(c)(i)(G) requires that a broker's broker's policies and procedures must "describe in detail the manner in which it will satisfy its obligation under subsection (a)(i) of this rule in the case of offerings and bid-wanted not conducted in accordance with section (b) of this rule." Furthermore, in times of volatile markets, a broker's broker may adjust its predetermined parameters as necessary to achieve their purpose: to identify most bids that do not represent fair market value. Additionally, broker's brokers using the safe harbor are not required to contact bidders under any circumstances. They are simply permitted to do so pursuant to the terms of

the safe harbor. They are required to contact sellers when the high bid is below the predetermined parameters. This is important to facilitating the receipt of fair market prices by retail investors. This notice draws potentially below market bids to the attention of selling dealers. The actual determination of whether the high bid is, in fact, below market remains the obligation of the selling dealer.

BDA also said that, if a broker's broker sets the pricing parameters too broadly on the upper end, erroneous bids would not be identified, the bidder would not be notified and might, in future dealings with that broker's broker, bid more conservatively or not at all. The result would be reduced liquidity in the market and lower prices for investors. It also said that, if the broker's broker set the pricing parameters too narrowly on the lower end, the selling broker would receive a notice and quite likely not go through with the trade, or risk litigation if it did. By definition, a broker's broker's predetermined parameters must be "reasonably designed to identify most bids that may not represent the fair market value of municipal securities that are the subject of bid-wanted to which they are applied." Furthermore, broker's brokers that use predetermined parameters are required to test them periodically to determine whether they have identified most bids that did not represent the fair market value of municipal securities that were the subject of bid-wanted to which the predetermined parameters were applied. The MSRB believes that these requirements should suffice to avoid the situations described by BDA.

TMC Bonds said that the predetermined parameters portion of the safe harbor would, in effect, force broker's brokers to subscribe to pricing services. It said that intermediaries, whether broker's brokers, alternative trading systems ("ATs"), or exchanges, should not be responsible for establishing prices or price bands, but instead should be responsible for running fair and efficient auctions. The MSRB notes that many broker's brokers and ATs already notify sellers when bids differ significantly from bids received in previous bid-wanted or offerings, recent trade prices on EMMA, or prices from pricing services. The use of predetermined parameters was actually suggested by a broker's broker as part of the comment process on an earlier version of Proposed Rule G-43. Furthermore, bidders using one ATs's software already receive an electronic notification if their bids are outside of certain pricing parameters and are required to take affirmative steps to resubmit their bids in such cases.

The MSRB notes that predetermined parameters established by broker's brokers pursuant to proposed Rule G-43 are intended to assist broker's brokers in their duties with respect to their clients and are not dispositive of the fair market value of the securities that are the subject of bid-wanted.

Proposed Rule G-43(c)(i)(E) -- Customer/Affiliate Disclosures. Proposed Rule G-43(c)(i)(E) would require a broker's broker to have policies and procedures that would require a broker's broker that allowed customers (as defined in MSRB Rule D-9) or affiliates (as defined in MSRB Rule G-11(a)(x)) to place bids to disclose that fact to both sellers and bidders in writing and to disclose to the seller if the high bid in a bid-wanted or offering was from a customer or an affiliate of the broker's broker. The broker's broker would not be required to disclose the name of the customer or affiliate.

Hartfield Titus, BDA, and R.W. Smith objected to the portion of Proposed Rule G-43(c)(i)(E) concerning pre-trade disclosure if the high bidder is a customer of the broker's broker. BDA also objected to the comparable portion of the proposed rule concerning affiliates. One concern expressed was that such disclosures would be inconsistent with the counter-party anonymity provided by most broker's brokers. The MSRB reiterates that the primary role of the broker's broker is that of trusted intermediary between selling and bidding dealers. While the MSRB has determined not to preclude dealers that are broker's brokers from having customers, it is concerned that such customers may sometimes present conflicts for such broker's brokers, hence the disclosure provisions of the proposed rule. The MSRB is of the view that a broker's broker effecting trades with an affiliate also is presented with conflicts and, therefore, has proposed the same disclosure rules as those for broker's brokers with customers. The MSRB notes that, if a customer's bid is the winning bid, the ensuing trade will be required under MSRB Rule G-14 to be reported to the MSRB within 15 minutes and identified as a sale to a customer, so the entire market will know whether a customer of the broker's broker won the bid-wanted or offering. The proposed rule does not require that the name of the customer be disclosed. Accordingly, the MSRB finds no substantive basis for these objections.

Proposed Rule G-43(c)(i)(H) -- Proprietary Accounts. Proposed Rule G-43(c)(i)(H) would require a broker's broker to have policies and procedures that would "prohibit the broker's broker from maintaining municipal securities in any proprietary or other accounts, other than for clearance and settlement purposes."

AAM said that the proposed definition of "broker's broker" would encompass dealers that have historically participated in new issue syndicates and proprietary trading of securities and, coupled with Proposed Rule G-43(c)(i)(H), force them to exit those portions of their business. The MSRB disagrees and notes that it would be highly unlikely for such firms to be considered to "principally effect transactions for other dealers" or to "hold themselves out as broker's broker," either of which is required for a dealer to be considered a "broker's broker" under Proposed Rule G-43(d)(iii). The MSRB reiterates that it has proposed a separate restriction on proprietary trading by broker's brokers, rather than incorporating the concept of proprietary trading in the definition of "broker's broker," because the latter approach would allow a dealer to avoid characterization as a broker's broker simply by executing a handful of proprietary trades.

Proposed Rule G-43(d)(iii) -- Definition. Proposed Rule G-43(d)(iii) would define "broker's broker" as "a dealer, or a separately operated and supervised division or unit of a dealer, that principally effects transactions for other dealers or that holds itself out as a broker's broker." An ATS that would otherwise satisfy the definition of "broker's broker" would not be considered a broker's broker if it "utilize[d] only automated and electronic means to communicate with bidders and sellers in a systematic and non-discretionary fashion (with the exception of communications that are solely clerical or ministerial in nature and communications that occur after a trade has been executed)" and satisfied certain other conditions.

AAM objected to the basic definition of broker's broker. It suggested a more detailed definition of broker's broker to include the nature and role of a broker's broker as well as the

duties and responsibilities of a broker's broker, noting that the Securities Industry and Financial Markets Association had made a similar comment in response to an earlier draft of Proposed Rule G-43. As the MSRB previously responded to SIFMA:

The definition proposed by SIFMA would make it easy for a firm to escape classification as a broker's broker and, accordingly, avoid application of the rules for broker's brokers. For example, a firm could simply carry customer accounts and avoid classification as a broker's broker, because part of the definition of a broker's broker proposed by SIFMA is that the firm not carry customer accounts. The MSRB continues to believe that the definition of broker's broker used in the Notice is the appropriate one. The MSRB definition of broker's broker (in draft Rule G-43(e)(iii)) is a functional definition. It focuses on the key function of a broker's broker -- effecting transactions in municipal securities on behalf of other dealers.

The MSRB continues to be of the view that a function-based definition of "broker's broker" is appropriate, rather than a detailed list such as that proposed by AAM.

AAM also objected to the portion of the proposed definition that would include dealers that "hold themselves out" as broker's brokers. The MSRB has previously noted that selling dealers rely on broker's brokers as trusted intermediaries. A selling dealer should be entitled to rely on the representations of another dealer that it is a broker's broker. A dealer should not call itself a broker's broker if it does not want to be subject to Proposed Rule G-43. So too, a dealer would not be able to avoid the provisions of Proposed Rule G-43 simply by not calling itself a broker's broker. AAM's reference to any inconsistency between the definition of "broker's broker" in Proposed Rule G-43(d)(iii) and the definition of "broker's broker" in the MSRB's Glossary is misplaced. As the preface to the Glossary notes, "the definitions contained herein do not represent definitions "officially" adopted by the MSRB." Should the Commission approve Proposed Rule G-43, the MSRB plans to conform the Glossary definition of "broker's broker" to that found in Proposed Rule G-43(d)(iii). Among other things, AAM and the Glossary definition do not recognize that broker's brokers in some cases have customers. The MSRB previously reached the conclusion that, with certain disclosures, it was appropriate to allow broker's brokers and ATSS to have customers.

BDA asked for clarification on the types of communications engaged in by ATSS that would be considered to be "clerical and ministerial." "Clerical and ministerial" is a term that already has meaning under MSRB Rule G-3 (*i.e.*, an individual whose duties are solely clerical and ministerial is not required to pass an MSRB professional qualifications examination). Examples of clerical and ministerial communications would be customer service types of communications, such as technology-related questions. Any type of communication that could only be engaged in by an individual that is licensed under MSRB Rule G-3 would not be considered to be clerical and ministerial.

TMC Bonds said that the exception from the definition of "broker's broker" for ATSS should also encompass ATSS that provide "voice support." It suggested that software support

would be precluded by the definition. The MSRB notes that software support would likely fall into the category of “clerical and ministerial communications,” which are not precluded by the rule. The type of voice communication that concerns the MSRB is that engaged in between ATS traders and bidders. If the traders have access to information about bids, there is no way to ensure that those traders do not engage in the same types of activities that have been the subject of enforcement actions against traditional voice brokers (*e.g.*, bid coaching). The MSRB notes that some ATSS that are purely electronic have developed mechanisms for bidders to request automatic electronic alerts when securities of the type in which such bidders have interest are available on the ATS.

Rule G-8 -- Recordkeeping. The Proposed Amendment to MSRB Rule G-8 would require broker’s brokers to maintain certain records concerning bid and offer prices and communications with sellers and bidders.

BDA characterized the recordkeeping provisions of the proposed rule change as burdensome, particularly those concerning offerings. The recordkeeping provisions of the proposed rule change are designed to permit effective enforcement of the provisions of Proposed Rule G-43 and many were actually recommended by broker’s brokers themselves. The MSRB notes that the proposed rule change already reflects a change from a previous version of the proposed rule change made at the request of broker’s brokers concerned with the recordkeeping provisions for offerings. As the MSRB noted in its filing, “The MSRB agrees with the comments concerning records of offers and has amended the rule to require that a broker’s brokers’ records concerning offers must include the time of first receipt and the time the offering has been updated for display or distribution.” Records concerning offering prices are not, as suggested by BDA, required to be kept for every change in offering price throughout the course of the day.

Miscellaneous. AAM and BDA questioned the need for Proposed Rule G-43 and said that enforcement of existing MSRB rules would suffice to address any issues concerning the conduct of broker’s brokers.

In response to this same comment, which was raised in response to a request for comment on an earlier version of Proposed Rule G-43, the MSRB said: “While the MSRB’s Rule G-17 is broad in its scope and could be used to address much of the conduct of broker’s brokers described in the SEC and FINRA enforcement proceedings cited in the request for comment on draft Rule G-43, the MSRB believes that broker’s brokers need more explicit direction as to the appropriate conduct of bid-wanted and offerings. It is sometimes difficult for enforcement agencies to prove that conduct is fraudulent, and allegations that conduct is unfair under Rule G-17 are sometimes met with the argument by the alleged violators that they have not been properly put on notice of the type of conduct that is considered unfair. Accordingly, the MSRB is of the view that a specific rule governing the conduct of broker’s brokers is warranted. The MSRB notes, however, that draft Rule G-43 would not replace Rule G-17, which is an over-arching rule and applies even when there is a more specific rule on point.” In its filing of the proposed rule change, the MSRB also noted that, “Enforcement agencies have informed the

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MSRB that they continue to observe the same kinds of series of transactions in municipal securities that prompted the MSRB's 2004 pricing guidance. They have also informed the MSRB about their observations of other trading patterns that indicate some market participants may misuse the role of the broker's broker in the provision of secondary market liquidity and may cause retail customers who liquidate their municipal securities by means of broker's brokers to receive unfair prices."

If you have any questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in blue ink that reads "Margaret C. Henry". The signature is written in a cursive style.

Margaret C. Henry
General Counsel, Market Regulation