

RW Smith & Associates, Inc.

April 27, 2011

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: MSRB Notice 2011-18: Request for Comment on Draft Rule G-43 on Broker's Brokers and Associated Amendments

Dear Mr. Smith:

RW Smith & Associates, Inc. ("RW Smith") appreciates this opportunity to respond to the Municipal Securities Rulemaking Board's ("MSRB") Notice 2011-18 (the "Notice") in which the MSRB requests comments on draft Rule G-43, and the associated amendments to Rules G-8, G-9, and G-18 regarding municipal securities broker's brokers ("MSBBs"). RW Smith has also participated extensively in the drafting of the comment letter on the proposed rule being submitted by the Securities Industry and Financial Markets Association ("SIFMA") and strongly supports the views contained therein. In addition to the SIFMA comment letter, we believe that aspects of the proposed rule pose substantive risks to the efficient operation of the municipal securities secondary market, especially the retail sector of this market, and are worthy of an additional underscoring response.

To begin, RW Smith believes that the current MSRB rule set is appropriate for the governance of transactions effected in the secondary interdealer municipal market and questions the necessity of layering on disruptive and inefficient rules. We would point to the enforcement cases cited by MSRB as an example of the regulatory framework and system working as intended. Audits were performed, violations discovered, investigated, enforced upon, and press releases were released notifying the industry and public of noted violations and sanctions. Based on those enforcement actions and with a specific eye to the transgressions noted in the summaries, broker's brokers around the country reviewed internal policies and procedures to assure compliance with all applicable MSRB rules and the new interpretations pertaining to the broker's broker business model. In the end, we believe the regulatory framework worked exactly as intended with positive consequences to the market and investing public, and do not believe the proposed regulation is necessary or appropriate. Further, we are concerned the proposed rule will negatively affect liquidity in the marketplace, specifically in the retail sector of the market, and that elements of the proposed rule are anti-competitive.

Definition of a Broker's Broker

The Municipal Securities Broker's Broker committee at SIFMA submitted an updated and accurate definition of the broker's broker business model, so did SIFMA in their G-43 comment letter last fall, and both attempts at establishing a baseline definition of the business model have been rebuffed. It is unclear how the regulatory agency intends to regulate a business model that it

has yet to define. The SIFMA MSBB committee recognized this fundamental issue early on and has attempted on numerous occasions to work with the MSRB in good faith to help them define the sector in an effort to provide the foundation from which to apply the current rule set. We are the people who actually know what this business model is, how it functions every day in the marketplace, and how it needs to be defined to prevent any broker's broker firms from being able to "escape classification as a broker's broker" and we are excited to work with the MSRB on this subject. RW Smith (and a host of other broker's broker firms) remains ready to work with the MSRB on this matter because we believe this is where the conversation needs to start, and then expand into rule set application.

RW Smith respectfully proposes the MSRB update the definition of a broker's broker, as a foundational piece of regulation from which all current applicable rules should be applied, using the updated and accurate definition created by the SIFMA MSBB Committee. This comprehensive definition of a broker's broker will promote the clarity that the MSRB is seeking; the role and limited duties & responsibilities of the broker's broker would be known and understood by all market participants. Further, a firm failing to comply with the definition would not be permitted to "hold itself out as" a broker's broker.

Agency vs Principal

Broker's brokers execute transactions on the broker desk in either agency capacity or riskless principal capacity, but never in principal capacity. Broker-dealers execute proprietary transactions in principal capacity, broker's brokers however are restricted from maintaining securities positions and do not execute transactions in principal capacity.

When it comes to reporting the transactions into the RTRS brokers who execute riskless principal transactions are forced to report their trades in as principal trades, but this is a technicality and only occurs because the MSRB did not create a riskless principal reporting code. But let's not let a system code confuse the situation: broker's brokers do NOT execute their transactions on the broker desk in principal capacity – ever. If they do, they are not a broker's broker, they are a broker-dealer affecting trades for their own account.

Pre-Trade Written Disclosures

The proposals for pre-trade written disclosures throughout this Notice would discourage dealers from committing capital to the secondary market, would slow down trading (if not prohibit it in many instances), and would likely lead to a substantial loss of liquidity in the marketplace.

We would like to specifically comment on the MSRBs statement that "most retail customers would prefer a better price to a speedy transaction" – we found that statement to be dismissive of the point being made by SIFMA in their comment letter and wholly inaccurate in our vast real-world experience as a leading interdealer broker. The scenarios that drive bondholders to bring their securities to market for potential liquidation are as varied as the individuals who own the securities. There are many, many instances when speed of execution is the driver of a transaction, not price, and dealers across the country brought this point up to us after reading the MSRBs rule proposal response to comment letters document.

Bid Verification on Suspected Errors

RW Smith agrees that if an MSBB believes a bid has been submitted in error that before they contact the bidder they should either get permission from the seller or provide prior notice to the seller of their procedures on the handling of suspected erroneous bids. The proposal suggests that all bidders should be contacted, not just the possibly erroneous bid that will be given to the seller for consideration of liquidation, that is a waste of everyone's time and does not positively affect the outcome of the auction process.

The solution to the MSRBs main area of concern (integrity of the auction process) is simple, draft an Interpretation wherein all broker's brokers are advised (read required) to provide prior written notice to the seller of the securities what their policy is regarding bid verification. Broker's brokers are intrinsically circumspect with bid verification, and this is aside from their company's restrictive policies on this subject, because backed-off bids do not typically buy bonds. Nowadays brokers verify bids only when they believe a mistake may have been made in the bidding calculation process—for example, this happens daily with bids coming through Fabkom where bidders are scrolling through thousands of bid wanted items from various firms and they miss a call feature, bid the wrong line item, or just fat finger their online bid.

Brokers have integrity, let them do their job and protect the potential seller (and market) from a bad trade.

Further, requiring “written instruction” to correct a mistake on a bid is unnecessary and needlessly adds work for no reason; it would delay the process and burden the bidder with no improvement to liquidity, efficiency, or price transparency. By the way, RW Smith has designed an innovative trading platform with Zia Corporation and our system records all bids received, who entered the bid and the time stamp, any amendments to those bids, who made those edits and when, along with the reason why any bid was changed or withdrawn. To our knowledge, all reputable broker's broker maintain full and accurate books and records, including complete bid pad archivals.

Finally, RW Smith holds that rulemaking that is written for and applied only to the voice broker/hybrid model and not to the electronic trading platforms is anti-competitive.

Rule G-18

The Proposed Guidance regarding Rule G-18 not only provides additional guidance to help MSBBs in meeting their obligations under Rule G-18, but also substantially modifies the current rule. We believe that this proposal inappropriately places the primary burden of determining whether a transaction should occur on the MSBB, rather than on the sellers of securities. The MSBB's role in these transactions is to seek to provide their trading counterparties with information about the market for the securities in question at the time in question. The determination of whether a resulting high bid is fair, especially in a market as thinly traded as the municipal securities secondary market, is inherently subjective, and is one which the seller is clearly in a better position to make, and which the MSRB requires that dealers make when acting as principal for their customers.

Broker's brokers are not traders. Both broker's brokers and traders are clear on this point, however it does not appear the MSRB is clear on the distinction between the two roles in the marketplace. Is it the role of a broker's broker to clearly and completely communicate the specifics of the information and data they have acquired in the pursuit of performing their job – absolutely. Is it the role of the broker's broker to determine fair market value of a security based on the limited scope of their picture (MSRB historical pricing, internal historical pricing, and the current bid pad which typically does not contain all of the bids on an item because broker's brokers are almost always “in competition away”, meaning the originator of the bid wanted has pieces of the market picture that the broker's broker does not have access to) and subsequently advise a professional bond trader as to whether or not they should buy or sell their positions – no. A broker's broker acts strictly in the limited capacity of an intermediary in the interdealer market. The role of a broker's broker is and has always been to properly and fairly conduct a bid wanted auction; the fundamental responsibility of the broker's broker is to ensure that the auction is widely disseminated (unless distribution is restricted by the seller) and well-run.

The pre-trade requirements proposed by the MSRB are untenable and it is universally agreed by knowledgeable market participants the real-world effect of the application of this rule proposal will strip liquidity from the market. Specifically, retail market participants and especially those desiring the liquidation of their small, odd lot positions will suffer the brunt of this loss of liquidity. The negative impact on the retail market holds the distinct possibility of deterring participation in the municipal fixed income market in general, which will then bleed into and affect the primary market. Loss of liquidity may impede the ability for issuers to raise capital; we see the likely loss of liquidity as something that will throw off ripples that will most likely touch all corners of the municipal bond market.

We are confident the unintended consequences mentioned, along with many others not enumerated herein, are surely not the intent of the Board, but we feel compelled to mention them so they are not overlooked.

Rule G-17

RW Smith agrees with the Proposed Guidance's statement that, like all other municipal securities dealers, Rule G-17 applies to MSBBs, and that all dealers have an obligation not to act in “any unfair, deceptive or dishonest manner” in the conduct of their securities business.

MSBB's and Non-Dealer Counterparties

Broker's brokers are not only procedurally bound, but are ethically bound to treat all counterparties the same in the execution of their responsibilities as a broker's broker, whether they are broker-dealers, dealer banks or institutional accounts. (To date we do not know of any broker's brokers or interdealer brokers in the municipal market who are executing transactions directly with retail customers, which is why we have not listed retail accounts here.) MSRB proposes that broker's brokers be required to restrict the flow of information and data to institutional customer contra-parties; RW Smith does not agree with the MSRBs attempt to bifurcate the market through preferential treatment to the dealer community and, point of fact, believes it would be an anti-competitive move against institutional customers.

Electronic Trading Systems

RW Smith completely agrees with SIFMA's position that the MSRBs request for comment on the standards to be applied to electronic trading systems is anti-competitive. Imposing less stringent requirements on electronic trading systems would give them an unfair advantage over traditional broker's brokers.

If the Board continues down this path, we would request a detailed explanation of how excluding electronic MSBBs from certain provisions of the proposed rule would benefit the market and the investing public. We would also request the Board address the anti-competitive issue that would clearly exist if they persisted with granting preferential treatment to electronic trading systems over traditional broker's brokers. Finally, we would like to ask the Board to specifically address the issue of electronic MSBBs that are owned by a dealer or multiple dealers, as well as the possible conflicts of interest with members of the Board who may work for some of these dealer-owners.

It seems prudent for the Board to avoid anti-competitive rule-making so we would oppose this approach and recommend the Board move away from this type of preferential treatment to favored market participants.

Thank you, again, for the opportunity to comment on these important matters and we would like to reiterate that, in addition to this comment letter, RW Smith participated in and fully supports the SIFMA comment letter.

Sincerely,

Paige W. Pierce

Paige W. Pierce
President & CEO
RW Smith & Associates, Inc.