

**Wolfe & Hurst Bond Brokers, Inc.
30 Montgomery Street
Jersey City, New Jersey 07302**

April 21, 2011

Via e-mail and regular mail

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

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

Dear Mr. Smith:

Please accept this letter as the response of Wolfe & Hurst Bond Brokers Inc. (hereinafter "WHBBI") to the Municipal Securities Rulemaking Board's (hereinafter "MSRB") Notice 2011-18: Request for Comment on MSRB Guidance on Broker's Brokers, dated February 24, 2011. WHBBI also supports the comment letter submitted by the Securities Industry and Financial Markets Association (hereinafter "SIFMA").

WHBBI initially questions the need for and purpose of Proposed Rule G-43. The MSRB contends that additional rulemaking is necessary as a result of clear violations of the current rules by many broker's brokers. WHBBI reiterates SIFMA's position that these new rules do not serve their intended purpose. The existing rules provided FINRA ample opportunity to sanction broker's brokers for activities it felt constituted a violation. The broker's brokers have incorporated the results of those sanctions into their business model and thus there is no need for additional rules but only for enforcement by the regulatory bodies. The market would be better served if the MSRB and FINRA monitored and enforced current rules rather than creating disruptive and unworkable new regulations. As discussed below, the Proposed Rule inhibits the role of the broker's broker in the secondary market and will have the severe unintended consequence of significantly limiting liquidity for retail customers in the bond market.

I. Rule G-43

A. Definition of a Broker's Broker

MSRB Proposed Rule G-43(e)(iii) defines a broker's broker as (1) "a dealer, or separately operated and supervised division or unit of a dealer, (2) that principally effects transactions for other dealers or (3) that holds itself out as a broker's broker. A broker's broker may be (4) a separate company or (5) part of a larger company." In their responsive submissions

to MSRB Notice 2010-35, WHBBI and SIFMA suggested an alternative definition of a broker's broker. Generally, WHBBI argued and maintains that the proposed definition of a broker's broker failed to adequately identify the role and responsibilities of a broker's broker and its important role in the market.

WHBBI recognizes and appreciates that some of the definitional aspects proposed in the comment letters previously submitted by SIFMA and WHBBI were incorporated into section G-43(d)(i) and apart from the definition of a broker's broker in section G-43(e)(iii). For instance, Proposed Rule G-43(d)(i)(C) prohibits a brokers' broker from maintaining municipal securities in any proprietary or other accounts, other than for clearing and settlement purposes. As written, Rule G-43(d)(i)(D) prohibits the participation in syndicates and section G-43(d)(i)(E) requires broker's brokers to execute equally matched trades contemporaneously. While incorporating these aspects into the broker's broker written supervisory procedures is appropriate, WHBBI contends that this tactic leaves the definition inadequate and unclear. The MSRB suggests that incorporating these restrictions in a more expansive definition of a broker's broker would allow "... a firm to escape classification as a broker's broker and, accordingly, avoid application of the rules for broker's brokers." By way of example, the MSRB notes that, "... a firm could simply carry customer accounts and avoid classification as a broker's broker..." For reasons further elaborated in section I(E)(ii) below, WHBBI disagrees with this assessment, especially since a firm carrying customer accounts is not a broker's broker. The limited definition proposed by the MSRB fails to encompass the limited and unique role that a broker's broker actually holds in the market.

A more specific and comprehensive definition of a broker's broker would promote the transparency and clarity sought by the MSRB. Such a definition would also put the broker-dealers utilizing the services of a broker's broker on notice of the duties and responsibilities it should expect to have owed to it and alleviate the MSRB's concern in this regard. A firm failing to abide by the definition, *i.e.* by maintaining customer accounts, should not be permitted to operate as a broker's broker. Thus rendering the phrase "or holds itself out as a broker's broker" unnecessary. **The MSRB should reconfirm and utilize the traditional definition of a broker's broker.** Specifically:

- (1) a true broker's broker acts as an agent strictly for broker-dealers and dealer portions of banks in the purchase or sale of fixed income instruments in the secondary market.
- (2) a true broker's broker does not have or maintain customer or proprietary accounts, other than for clearance and settlement purposes.
- (3) a true broker's broker does not conduct any business with customers, including institutions and Sophisticated Municipal Market Participants ("SMMP's").
- (4) a true broker's broker does not hold or receive customer funds or securities.
- (5) a true broker's broker is compensated by a commission rather than a mark-up.
- (6) a true broker's broker acts as an auctioneer in that it receives a bid-wanted and seeks to obtain bids on that item which satisfy the conditions set by the selling broker-dealer or dealer portion of a bank.
- (7) a true broker's broker never and should never participate in the decision to execute a securities transaction or make a determination as to the reasonableness of the price resulting from a bid-wanted auction.

(8) a true broker's broker provides ease to transactions between broker-dealers, which has a particularly significant impact on the ability of owners of small retail-size lots and thinly-traded issues to find liquidity.

(9) a true broker's broker executes all trades as an agent.

Modifying the traditional definition of a broker's broker in the secondary market undermines the important and necessary role that broker's brokers have in providing efficiency, liquidity, and access to the secondary market. If the broker's broker desires to change their model to be more in-line with the broker dealer, compel them to make such a change in the model and deny them the benefits of conducting themselves as a broker broker.

B. Duty of a Broker's Broker

i. Fair Pricing Requirement

Proposed Rule MSRB G-43(a)(i) requires that broker's brokers "...make a reasonable effort to obtain a price for the dealer that is fair and reasonable in relation to prevailing market conditions." The Proposed Rule further requires a "broker's broker to employ the same care and diligence in doing so as if the transaction were being done for its own account." The MSRB explains that it "... expects that, if broker's brokers were selling securities for their own account, they would take all of their knowledge about the securities into account in determining whether the bid-wanted had resulted in a fair and reasonable price."

WHBBI maintains that such a responsibility should not be placed on broker's brokers. Broker's brokers should be required to make an effort to conduct a well-run and widely disseminated bid-wanted auction. In addition, WHBBI agrees that a broker's broker "...must not take any action that works against the client's interest to receive advantageous pricing" as required by proposed Rule G-43(a)(ii). However, a broker's broker cannot be expected to make a determination as to the reasonableness of the high bid in relation to fair market value of the security. This is not what is expected of them by their clients and would indeed be a hindrance to them. The role of a broker's broker is and has always been to conduct a bid-wanted auction. Basic auction rules dictate that the responsibilities of the auctioneer or broker's broker do not include any evaluation as to the reasonableness of the price. In both cases, the buyer and seller determine whether they agree to the best bid obtained at the close of the auction or bid-wanted.

Moreover, it is not practicable or efficient to require a broker's broker to determine whether a bid-wanted results in a fair and reasonable price. This responsibility should remain with the professionals that are employed in such a capacity on behalf of their customers. A broker's broker acts strictly as an intermediary for broker-dealers and dealer portions of banks. As such, the broker's broker does not engage in making determinations as to the fair market value of the security and such an obligation should not be imposed on them. The MSRB noted that in order to conduct a proper bid-wanted auction broker's brokers consult their trading history, bid pads, past history, execution history and ticketing/operational history. A huge flaw of using historical data is that there is a presumption that all underlying elements then are appropriate now. This demonstrates a lack of understanding on the part of the regulators. Many of these referenced tools are repetitive and would not provide additional information to serve the end of determining a fair and reasonable price. The suggestion that the broker's brokers consider

the past history is not relevant in conducting a proper bid-wanted auction. Overall, this information is insufficient to make a determination as to whether the result of a bid-wanted equates to the fair market value of a security. Importantly, a broker's broker is not privileged to adequate information with which it might be able to "employ the same care and diligence ... as if the transaction were being done for its own account." This is a ridiculous standard. The investment desires could and probably are different from the customer versus the brokers' broker. For example, a broker's broker is not privy to information regarding new issues and does not receive a copy of the official statement distributed by the municipal issuer whereas a broker-dealer or dealer bank is entitled to such documents. Moreover, a broker's broker does not have information regarding the customer making it unable to determine whether a given bid-wanted result is suitable.

Additional factors make it impractical for a broker's broker to determine fair market value. For instance, many bonds which are the subject of securities transactions executed by broker's brokers are not regularly traded or rated (unlike equities), making it unfeasible to determine the current market value on the basis of the history available to the broker's broker. This restricts the ability of a broker's broker to comply with proposed rule G-43(c)(i). Similarly, there are circumstances wherein it would be unclear whether a broker's broker should make the required written disclosures. For instance, a client of the broker's broker that regularly bids on certain items may be out of the office on a given day and unable to enter a bid. It is unclear under the proposed rule whether this is a circumstance where the broker's broker would be required to obtain written permission from the client to move forward with the transaction. Contrary to the MSRB's position, these circumstances, amongst others, would result in frequent disclosures proposed by Rule G-43(a)(iv) which would undoubtedly cause a disruption to the market and significantly limit liquidity for retail customers.

Requiring a broker's broker to determine whether a given price is fair and reasonable may have additional unintended consequences. The broker's broker may ultimately be held liable for making such recommendations despite the fact that they were not privy to all information necessary to make the initial recommendation. Such repercussions were recently demonstrated when the Internal Revenue Service audited general obligations bonds issued in 2005 and inquired as to whether or not they should have been issued as tax-free municipal bonds. Similarly, under the Proposed Rule the broker's broker could become liable for comparable mistakes even though it does not have access to important information such as the issuer's official statement. Ultimately, the responsibility of determining fair pricing must remain with the professional broker-dealer or dealer portion of banks who dictate the terms of the bid-wanted auction and possesses all necessary information.

Due to their limited role as an intermediary, broker's brokers should not be required to make any determinations as to the reasonableness of a price in relation to prevailing market conditions. The clients of a broker's brokers, broker-dealers and dealer portions of banks, are in a far better position to make a determination as to whether a price is fair and therefore this responsibility should be solely imposed on them. Contrary to the stated purpose of the MSRB, imposing these responsibilities on broker's brokers will have the unintended consequence of stripping the market of liquidity for retail customers, especially those attempting to sell small lots.

ii. Agency and Written Disclosures

MSRB's Notice 2011-18 states that Proposed Rule G-43 no longer addresses whether broker's broker execute trades on an agency or principal basis. The Notice provides that if a broker's broker has customers, its pricing obligations to them will be governed by either Rule G-18, in the case of agency trades, or Rule G-30, in the case of principal trades. WHBBI contends that a broker's broker should be prohibited from having customers, or maintaining customer accounts as suggested in Proposed Rule G-43(d)(i)(C). As such, *all trades executed by a broker's broker will be agency transactions.*

Rule G-43(a)(iii) permits broker's brokers to act as agent for both potential seller and bidders in a bid-wanted if it has received express consent from the potential seller and bidders. The MSRB interpreted SIFMA's concern that written disclosures would discourage dealers from committing capital to the secondary market as a concern that written disclosures would slow down trading. The MSRB stated that it believed "most retail customers would prefer a better price to a speedy trade." **This is not accurate as there are many instances where a customer requires prompt liquidation of assets and it is not the role of the broker's broker to impede on the transaction.** WHBBI further contends that it would be unworkable and inefficient to obtain express consent from each bidder for each transaction. This would not only decrease the speed at which transactions are processed, but could prevent the trade entirely. Requiring such disclosures would have a substantially detrimental effect on the liquidity so valued in the market. This is especially true for retail or small transactions. If the MSRB is insistent on requiring written consent from all parties to act as agent, WHBBI suggests that the MSRB authorize a blanket acknowledgement at the outset of the relationship of the broker's broker with the broker-dealer or dealer portion of a bank. Under this proposal, if a broker-dealer or dealer portion of a bank refuses to consent to the broker's broker acting as agent for both the seller and the buyer, then the broker's broker should not do business with that firm.

C. Use of Bid-Wanted

Proposed Rule G-43(b) states that "a bid-wanted conducted in a manner that satisfies the requirements of section (c) of this rule will generally satisfy the obligation of a broker's broker under section (a)(i) of this rule, depending on the specific facts and circumstances of the transaction. Yet in its comments to the responses received regarding Notice 2010-35, the MSRB suggested that the obligation of a broker's broker is more than to conduct a well run bid-wanted. In addition, the MSRB stated that "...whether the bid-wanted actually satisfies this duty will depend on the specific facts and circumstances of the transaction, including whether the broker's broker has satisfied its duty of fair dealing under Rule G-17."

WHBBI does not dispute its responsibility under Rule G-17 to avoid "...engag[ing] in any deceptive, dishonest or unfair practice." However, the proposed Rule is unclear as to the circumstances under which the requirements of subsection (c) will not be met. It is also requested that the MSRB clarify how it is that compliance with G-43(c) generally satisfies the obligations of G-43(a) yet the Proposed Rule further requires a broker's broker to conduct its

business as though it were transacting for its own account (which may have different reasons for buying or selling).

D. Correcting Bids and Preferential Treatment

Proposed Rules G-43(a)(iv), G-43(c)(iv), and G-43(c)(vi) relate to the ability of a broker's broker to correct clearly erroneous bids. As discussed above, a broker's broker should not be responsible for making a price determination regarding the current fair market value of a security. However, bids may be submitted that are clearly erroneous, *i.e.* far above or below all other bids received. *It is important that such erroneous bids not reach the marketplace.* A bid may result from unavoidable human error, *i.e.* entering a bid on item number "11" rather than properly on item "111." When it is clear that such an error has occurred, the broker's broker should be permitted to promptly ensure that it is corrected.

Proposed Rule G-43(c)(vi), which requires the broker's broker to obtain written permission from the seller to contact a bidder regarding an erroneous bid, is not viable. This proposed rule sets a precarious standard in that if the seller refuses to grant such permission, the broker's broker will be required to accept the clearly erroneous bid. This will result in erroneous bids entering the market place and being viewed by the public. Allowing a clearly erroneous bid is unfair trading and dishonest and should not be a requirement imposed on the broker's brokers by the MSRB. It is also contradictory to the policy behind the recent Market Access Rule of the Securities Exchange Commission concerning the prevention of erroneous bids from entering the market. Moreover, impeding on the broker's brokers ability to correct erroneous bid submissions will also damage the important relationship of the broker's broker with that bidder. This will also lead to more disputes and arbitrations since the broker-dealer who submits an erroneous bid will more than likely refuse to accept the fixed income securities that were the subject of a mistaken transaction.

In the alternative, the Proposed Rule suggests that if there is advanced disclosure to the client, then the broker's broker may notify all bidders for the bonds that a potentially erroneous bid for the security has been submitted and offer all bidders the opportunity to adjust their bids. However, allowing all bidders to adjust their bids in the case of the submission of one clearly erroneous bid is a manipulation of the market. It is likely that all bidders would reconsider and/or resubmit their bid. This does not foster the MSRB's ultimate goal of attaining fair prices or liquidity for retail customers.

Similarly, Proposed Rule G-43(c)(iv) prohibits broker's brokers from giving preferential information to bidders in bid-wanted on where they currently stand in the bidding process (including, but not limited to, "last looks," directions to a specific bidder that it should "review" its bid or that its bid is "sticking out.") The MSRB stated its concern with the opportunity for abuse if broker's brokers are allowed to contact bidders selectively regarding bid prices prior to the deadline for the submission of bids. The MSRB also expressed its dissatisfaction with the prospect of relying on certifications from broker's brokers indicating that they only corrected clearly erroneous bids. WHBBI suggests that this is not a valid concern and should be overtaken by the public policy against erroneous bids. There must be a mechanism for correcting bids submitted in error without relying strictly on the seller who may opt to inappropriately accept

that bid. The efforts of a broker's broker to prevent erroneous bids from entering the public market should not be viewed as inappropriate preferential treatment.

Broker's brokers should be permitted to notify any bidder if their submission was clearly erroneous without the consent of the seller and without providing the opportunity to all bidders. This would foster the ultimate goals of a fair, transparent and efficient market.

E. Policies and Procedures

Generally, WHBBI agrees with Proposed Rule G-43(d). However, WHBBI suggests that Rule G-43(d)(i)(F) should be clarified to note that a broker's broker should be compensated specifically by commissions and Rule G-43(d)(i)(J) should be eliminated.

i. Commission

Proposed Rule G-43(d)(i)(F) provides that the compensation of a broker's broker must be disclosed to each contra-party in matched transactions. As discussed, since a broker's broker does not have customers and only acts on behalf of a broker-dealer or dealer portion of a bank, it should only be compensated by commissions. Other methods of compensation, *i.e.* through a mark-up, should remain reserved for those transactions with customers. WHBBI suggests that the MSRB add to the definition of a broker's broker that they are only compensated by commissions and not by a mark-up as set forth above.

ii. Customers

A true broker's broker does not and should not have customers. As discussed at length above, the role of a broker's broker is limited to acting as an intermediary and facilitating transactions on behalf of broker-dealers and dealer portions of banks. The previously followed SEC net capital requirements in Rule 15c3-1(a)(8)(ii) specifically prohibits a broker's broker from having customers. The section further prohibits a broker's broker from having or maintaining any securities in its propriety or other accounts. This rule remains in effect, thus any broker's broker conducting business with a customer would be violating the rules of the SEC.

Moreover, modifying this definition by permitting broker's brokers to conduct transactions with customers fundamentally alters the role of the broker's broker. By engaging in transactions directly with customers, including Sophisticated Municipal Market Professionals ("SMMP's") and institutions, broker's brokers would be practicing unfair dealing. Specifically, executing transactions with customers would by placing the broker's broker in direct competition with their clients. Broker's brokers have an agency relationship with their broker-dealer clients and transactions with customers would violate the duties imposed upon the broker's broker acting as agent. Preventing broker's brokers from having customers is not anti-competitive, as suggested by the MSRB. Broker's brokers have never had customers due to their limited role in the market and should not be permitted to engage in such transactions now.

Proposed Rule G-43(d)(i)(J) also contradicts proposed Rule G-43(d)(i)(C) which prohibits broker's brokers from maintaining any municipal securities in any proprietary or other

accounts, other than for clearance and settlement purposes. If a broker's broker cannot have customer accounts, then it follows that they cannot have customers and must act strictly as an intermediary.

II. Rule G-18

Proposed Rule G-18 should not apply to broker's brokers since it does not have customers. Please see above Section I(b)(i) for further elaboration of this point.

III. Electronic Trading Systems

With regard to electronic trading systems, WHBBI wholly agrees with SIFMA's position that the MSRB's 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. The MSRB suggests actions to be taken by an electronic trading system that expressly contradict the requirements to be imposed on a traditional broker's broker. Specifically, the MSRB suggests that it may permit electronic trading systems to satisfy the requirements of proposed Rule G-43(a)(iv) and (c)(vi) by providing notification to a bidder of a potentially erroneous bid indicating that its bid deviates from the most recently reported trades for the security by more than a pre-determined amount. This rule is in fact the very behavior that the MSRB intends to prevent traditional broker's brokers from engaging in. Such a double standard would surely reduce competition in the market by providing electronic trading systems an unfair-advantage to the demise of the traditional broker's broker. The suggested rules are discriminatory against the broker's broker and should not be under further consideration. Any entity acting as a broker's broker should be held to the same standard under the MSRB Rules. Creating different standards for electronic trading systems would result in market manipulation forced by the regulatory bodies.

We appreciate the opportunity given to WHBBI by the MSRB to comment on Notice 2011-18 and welcome further discussion on the issues addressed.

Sincerely,

O. Gene Hurst
O. Gene Hurst
President

[legal/wolfhurst/msrb/msrbresponse/MSRBResponseToRequestForCommentNotice2011-18]