

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

November 5, 2010

Peg Henry, Deputy General Counsel  
Municipal Securities Rulemaking Board  
1900 Duke Street, Suite 600  
Alexandria, Virginia 22314

Re: MSRB Notice 2010-35: Request for Comment on MSRB Guidance on  
Broker's Brokers

Dear Ms. Henry:

Please accept this letter as the response of Wolfe & Hurst Bond Brokers Inc. (hereinafter "the firm") to the Municipal Securities Rulemaking Board's (hereinafter "MSRB") Notice 2010-35: Request for Comment on MSRB Guidance on Broker's Brokers ("Proposed Guidance"), dated September 9, 2010. The firm is concerned that the MSRB has a number of misconceptions regarding the role of a broker's broker in the municipal securities market. These misconceptions have led to the development of impractical, inefficient proposed rules that do not ultimately serve the interests of the customers the regulatory bodies intend to protect. As discussed in further detail below, many of the provisions in the Proposed Guidance may be applicable to broker-dealers but cannot similarly be applied to broker's brokers. The firm strongly suggests that the MSRB recognize a clear distinction between broker-dealers and broker's brokers and amend its Proposed Guidance accordingly. Elimination of this distinction will ultimately lead to the demise of the true broker's broker and their important function in the market.

The Rules of the MSRB should reflect a more expansive, function-based definition of a broker's broker. As discussed further below, the Rules should be tailored to the role of a broker's broker as an agent instead of as a principal in a securities transaction. Moreover, it must be noted that a true broker's broker is an intermediary and does not effectuate transactions directly with customers and therefore MSRB Rule G-30 never applies. In addition, a broker's broker should not be responsible under Rule G-17 for ensuring that all material information has been disclosed to the dealer's customer. These responsibilities belong to the broker-dealer.

While it generally supports the response to the Proposed Guidance filed by the Securities Industry and Financial Markets Association ("SIFMA"), the firm notes that it does not effect transactions with *any* customers, including institutional investors or sophisticated municipal market professionals ("SMMP's"). The firm believes that a true broker's broker cannot effectuate transactions with such counterparts and that the MSRB's definition should be so modified. The use of a business model by broker's brokers which authorizes transactions with institutions and SMMP's permits unfair dealing and should be prohibited.

## I. The Definition of a Broker's Broker in the Proposed Guidance is Insufficient

The Proposed Guidance defines a broker's broker as a "broker, dealer, or municipal securities dealer that principally effects transactions for other brokers, dealers, and municipal securities dealers ("dealers") or that holds itself out as a broker's broker." This definition is deficient and fails to adequately define the role and responsibilities of a true broker's broker.

A broker's broker has a very limited and unique role that is essential to the securities market. A true broker's broker acts solely as an intermediary agent on behalf of a broker-dealer or dealer bank in effectuating contemporaneously matched debt securities transactions. A broker's broker does not do business with customers as defined by the MSRB. Moreover, a broker's broker does not maintain customer or proprietary accounts, or position securities. Thus, a broker's broker never acts as a "dealer" for its own account.

The definition set forth in the Proposed Guidance is so limited in scope that it does not accurately depict the essential role of a broker's broker in the securities market. Broker's brokers play an important role in providing liquidity, efficiency, transparency and access to the market. The firm recommends that the MSRB amend its proposed definition to reflect the broker's broker unique role in the market.

## II. A Broker's Broker Should be Considered an Agent of its Clients: Broker-Dealers and Dealers Portions of Banks

The Proposed Guidance provides that a "broker's broker effects principal transactions for dealer clients." According to the MSRB, the transactions of a broker's broker are considered principal transactions despite its agency relationship with one party. The firm strongly disagrees with this assessment. The Proposed Guidance notes that a principal transaction is effectuated by a broker's broker when it "...takes a position in a security sold by its dealer client, even if such position is solely in the clearing or similar account of the broker's broker and regardless of the length of time such position is held..." According to the MSRB, a position is taken in the securities when a broker's broker preserves the anonymity of the seller and the buyer through the clearing and settlement process.

The MSRB's stance in this regard does not consider the true function of a broker's broker. A true broker's broker does not act as a principal in the purchase or sale of municipal securities. As defined by Section 3(a)(5)(A) of the Securities Exchange Act of 1934, a dealer is "any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise." Section 3(a)(4)(A) of the Act defines a broker as "any person engaged in the business of effecting transactions in securities for the account of others." Thus, a broker-dealer is a firm engaged in the business of buying and selling securities for his own account or for the account of others. A broker's broker, however, acts as an intermediary between broker-dealers and dealer portions of banks in effectuating the purchase and sale of securities. Acting in this limited capacity, a broker's broker does not participate in the decision to buy or sell bonds nor does it exercise discretion as to the price or time at which a trade is executed. At all times the broker's broker's client controls the transaction and sets the parameters for the auction in a bid wanted. As agent, the broker's broker cannot complete a transaction without prior approval from the broker-dealer. Thus, a broker's broker acts as an agent for the broker-dealer, or principal, in the transaction. As such, a broker's broker has an obligation to act in the broker-dealer's interest and not to act for its own account.

Moreover, a municipal broker's broker does not maintain securities in its account or hold securities for clients. Indeed, it is specifically barred from doing so by SEC Rule 15c3-1(a)(8)(ii). All transactions must be contemporaneously matched to ensure that the firm is not in possession of securities. Prior to effectuating a transaction, the broker's broker ensures that both the selling broker-dealer and buying broker-dealer have bound themselves to the deal. Thus, a broker's broker cannot be considered to position securities or to be involved in principal transactions since it only facilitates a pre-approved transaction between the selling broker-dealer to the purchasing broker-dealer. The mere fact that securities pass through a clearing account should not negate the true agency function of a broker's broker.

The distinction between a broker's broker and a broker-dealer, or an agent and a principal, is critical and should be incorporated into the Proposed Guidance. A "broker's broker" that maintains securities or exceeds the scope of an intermediary in a municipal bond transaction as discussed above should not be permitted by the MSRB a) to hold itself out as a broker's broker or b) to register as a broker-dealer acting solely in the capacity of a broker's broker. The firm further suggests that the regulatory bodies not only recognize a distinction between broker's brokers and broker-dealers but also allow broker's brokers to report all of their transactions as agents.

### III. Broker's Brokers Do Not Deal With Customers as Defined by the MSRB, Including Institutions and SMMP's

The Proposed Guidance provides that the MSRB acknowledges that some broker's brokers may effect occasional transactions with customers and that Rule G-30 applies if such transactions are principal transactions. The MSRB Rules define a customer as, "any person other than a broker, dealer, or municipal securities dealer acting in its capacity as such or an issuer in transactions involving the sale by the issuer of a new issue of its securities." As an intermediary agent involved in the purchase and sale of debt securities on behalf of principal broker-dealers and dealer portions of banks only, a true broker's broker has no customers as defined by the MSRB Rules. A broker's broker does not deal with the public or institutions, and is never involved in retail transactions. All of the clients of a broker's broker are Financial Industry Regulatory Authority ("FINRA") member broker-dealers and dealer banks and are deemed to be sophisticated.

A broker's broker does not do business directly with the broker-dealer's customers and Rule G-30 should not be applicable to the broker's broker. This is especially true since the broker's broker has no ability to determine that the price is "fair and reasonable in relation to prevailing market conditions." A broker's broker acts strictly in the capacity of an auctioneer that seeks the highest bids for the selling broker-dealer, or principal. Acting in this manner, the broker's broker does not have access to necessary information regarding its clients customer and thus should not be given the responsibility for determining whether the winning bid obtained in a bid-wanted auction results in a fair and reasonable price. The broker-dealer must ultimately bear the responsibility for determining whether accepting the highest bid obtained is in the best interest of the broker-dealer's customers. Based on these circumstances, a broker-dealer should have the responsibility under the MSRB Rules for assessing the credit risk of a security and providing its customers with material information that would affect price or yield and be relevant to a reasonable investor. A broker's broker should never be subject to Rule G-30.

#### IV. Broker's Brokers Obtain and Disseminate Bids But are Not Responsible for Making Fair and Reasonable Price Determinations Pursuant to MSRB Rule G-18

Rule G-18 states, "Each broker, dealer and municipal securities dealer, when executing a transaction in municipal securities for or on behalf of a customer as agent, shall make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions." This provision is also meant to apply to broker's brokers acting as an agent for a dealer. It is noted by the MSRB that Rule G-18 is considered satisfied by broker's brokers through bid-wanted auctions.

The firm contests the applicability as noted in the Proposed Guidance of Rule G-18 to broker's brokers. Rule G-18 applies when a broker, dealer, or municipal securities dealer acts for or on behalf of a customer as agent. As noted above, a broker's broker does not have customers as defined by the MSRB and thus at no point acts "for or on behalf of a customer." Therefore, the obligation under Rule G-18 to ensure that a fair and reasonable price is provided to the customer should not apply to a firm acting solely as a broker's broker. The firm, however, acknowledges its obligation to conduct a fair and reasonable process in a bid-wanted auction by seeking out the highest bids for a selling dealer through the extensive dissemination of a bid-wanted (*cf.* comments from the Brokers Advisory Committee in a publication of the Securities Industry and Financial Markets Association ("SIFMA") entitled *The Role of Interdealer Brokers in the Fixed Income Markets* at page 4 stating, "IBD's almost never know what the execution price will be and they necessarily must work to find the best acceptable price to the buyer and seller, in the hope of earning the right to facilitate that trade.").

The Proposed Guidance provides that a broker's broker has a duty to obtain and disclose information regarding the fair market value of the securities and to ensure that its recommendations are suitable for customers. As discussed above, a broker's broker acts as an auctioneer on behalf of broker-dealers and the dealer portion of banks, which are both deemed to be professionals by FINRA. The broker's broker does not opine as to the fair market value of the securities but rather appropriately relies on the quotation/bid provided by the broker-dealer or dealer portion of a bank on behalf of which the broker's broker acts.

This point is further emphasized through Rule G-13(b)(ii), which provides, "If a broker, dealer or municipal securities dealer is distributing or publishing a quotation on behalf of another broker, dealer, or municipal securities dealer, such broker, dealer, or municipal securities dealer shall have no reason to believe that the price stated in the quotation is not based on the best judgment of the fair market value of the securities of the broker, dealer or municipal securities dealer on whose behalf such broker, dealer, or municipal securities dealer is distributing or publishing the quotation." Pursuant to Rule G-13, a quotation is defined as "any bid for, or offer of, municipal securities, or any request for bids for or offers of municipal securities, including indications of 'bid wanted' or 'offer wanted'." It is the responsibility of the principal broker-dealer to ascertain and disclose information relative to the fair market value of the securities as well as to ensure that recommendations made to its customers are suitable. This position has been reiterated by the MSRB in the context of the applicability of Rule G-19 and G-30 to transaction chains in its January 26, 2004 publication which provides, "It should be noted that, in either case, the dealer retains the ultimate responsibility to its customer to ensure that the customer's price is reasonably related to market value." Moreover, the MSRB's April 30, 2002 Notice indicates that a broker's broker effecting agency transactions for other dealers could satisfy its G-18 responsibility regarding fair and reasonable prices if its services were

“...explicitly limited to providing anonymity, communication, order matching and/or clearance functions and the dealer does not exercise discretion as to how or when a transaction is executed.”

It is not practical to place the responsibility of determining fair market value on a broker's broker. A broker's broker cannot verify whether a given price is reasonable to a particular customer or assess the suitability of a security for the broker-dealer's customer since the broker's broker does not have access to the broker-dealer's New Account Form, which contains, among other things, the customer's identity and information regarding the customer's investment goals and risk tolerance. The broker-dealer must be solely responsible for informing its customer if it has been unable to determine a fair and reasonable price for the security. Additionally, since it is possession of material information regarding the customer, the broker-dealer should be exclusively responsible for determining whether a given security should be recommended to its customer. Thus, a broker's broker should disclose the highest bid obtained to the broker-dealer who in turn is responsible for ensuring that the price is reasonably related to the fair market value of the securities at issue. A broker's broker, acting as an agent for a broker-dealer or the dealer portion of a bank, should not be responsible for obtaining or disclosing the fair market value of a security.

#### V. Broker's Brokers Should Not be Responsible for Providing the Broker-Dealer's Customers with Material Information Pursuant to MSRB Rule G-17

Rule G-17 states, “In the conduct of its municipal securities activities, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.” An MSRB publication dated July 14, 2009 provides that Rule G-17 requires dealers to disclose material information to its customers regarding the municipal securities involved in a given transaction. Notably, the MSRB's May 30, 2007 publication discusses the responsibility of a dealer to ensure that it has “reasonable grounds” for believing a municipal securities transaction is suitable for recommendation to its customer. The Proposed Guidance reiterates the MSRB's position that some broker's brokers have customers. As discussed above, a true broker's broker does not have customers and the Proposed Guidance should be amended to reflect this fact. Accordingly, the broker's broker should not be required to determine whether a given transaction is suitable for a broker-dealer's customer nor should it be responsible for ensuring that all material information has been disclosed to the dealer's customer.

The firm further contests the MSRB's Proposed Guidance regarding preferential treatment to bidders in bid-wanted. The firm recognizes its responsibility under G-17 to refrain from providing “last looks,” cover bids and from altering bids without informing bidders and sellers. However, the firm maintains the position that it is not engaging in preferential treatment by asking a bidder in a bid-wanted to check their bid where it was clearly submitted in error. In taking this action, the broker's broker ensures that the bid of the likely buyer is bona fide and accurate as put forward, however, it does not advise the broker-dealer regarding the fair market value or otherwise opine as to the bid itself. In essence, the broker's broker is protecting the integrity, transparency and efficiency of the market. Thus, interpreting Rule G-17 to require a broker's broker to provide all bidders the opportunity to adjust their bids is inefficient and unworkable.

## VI. Concluding Remarks

In sum, a broker's broker does not act as a principal in municipal securities transactions, maintain or position securities, or act for its own account. A broker's broker acts as an intermediary agent on behalf of a broker-dealer or the dealer portion of a bank and does not deal directly with customers as defined by the MSRB. Since it does not have any customers, a broker's broker should not be liable under Rule G-18 for ensuring that the fair market value of the securities is provided to the broker-dealer's customers. Moreover, a broker's broker should not be responsible for ensuring that all material information is disclosed to the broker-dealer's customers or that its recommendations are suitable for the broker-dealer's customers. As it is required to possess information regarding its customer's identity and investment needs, the broker-dealer is in the position to disclose information related to the fair market value of a security as well as to assess whether a securities transaction is suitable for the customer. For all of the reasons discussed, it is this firm's position that a broker's broker should be considered distinct from a broker-dealer by the MSRB and other self-regulatory organizations. The Securities Exchange Commission ("SEC") previously permitted registration as a broker's broker. The SEC and other regulatory agencies should once again permit firms doing business as true broker's brokers to register as strictly broker's brokers rather than as broker-dealers acting in the capacity of broker's brokers.

Regulatory agencies must acknowledge not only the distinction between broker's brokers and broker-dealers but also the benefits that the broker's brokers offer to the bond market. Broker's brokers operate with limited liability and reduced capital in order to offer a unique service to the market. Particularly in times of market stress, bond broker's foster liquidity, improve market efficiency, and possess the distinctive ability to identify interested dealers and arrange trades. Rather than imposing impractical regulations on the broker's broker, regulatory bodies should strive to foster this specialized service, which enhances the market and ultimately provides investors with liquidity and therefore incentive to continue investing in the bond market.

We appreciate the opportunity given to the firm by the MSRB to comment on this Proposed Guidance and welcome further discussion on the issues addressed.

Sincerely,

A handwritten signature in black ink, appearing to read "O. Gene Hurst", with a long, sweeping flourish extending to the right.

O. Gene Hurst