December 31, 2009

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

Re: Comment Letter on Release No. 34-61110; File No. SR – MSRB-2009-17

Dear Secretary Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates this opportunity to comment on Release No. 34-61110 (the "SEC Release") on proposed amendments to Rule G-11 on new issue syndicate practices, Rule G-8 on books and records and Rule G-9 on preservation of records (the "Proposed Rule").

The Intent of the Proposed Rule is Ambiguous

In order to assess the proposed rule, it is essential to understand the practice it seeks to prevent. A review of MSRB Notice 2009-47 (the "MSRB Notice") and the SEC Release, however, fails to elucidate any single practice that is the object of the Proposed Rule. Instead, many practices are cited, which make the Proposed Rule a regulatory muddle.

*The MSRB Notice*

The MSRB Notice begins by citing the complaints of institutional investors whose orders are not filled only to find those same securities available in the secondary market at a higher price. According to the Notice, the institutional investors attribute this situation to retail dealers placing phantom orders or syndicate dealers purchasing bonds without filling their customers' orders. The MSRB Notice suggests that these two factors might also be limiting retail investors'

[1] SIFMA, or the "Association," brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

access to a primary issuance that is at odds with an issuer's intent. So, from the outset, the MSRB is attempting to take into account both institutional investors and retail investors, each of whom may not be receiving allocations of securities for different reasons.

*The SEC Release*

Regarding the intent of the Proposed Rule, the SEC Release makes two major statements: (i) the Proposed Rule is not directed against flipping securities; and (ii) the MSRB's goal is to achieve a broader distribution of municipal securities.

We do not believe it is correct to dismiss flipping securities as one of the practices the proposed Rule seeks to prevent for two reasons. First, the text of the MSRB Notice strongly suggests that preventing flipping securities is the intent, as it notes that institutional investors complained because the securities that they were not allocated in the primary issuance "became available shortly thereafter in the secondary market, *at higher prices* (emphasis supplied)."[2] Second, SIFMA was not the only entity to infer the anti-flipping motive; in fact, as noted in the SEC Release, four of the five comment letters filed with the MSRB made the same inference. While we disagree with the SEC's attempt to ignore the issue of flipping securities, we are sympathetic to its desire to avoid opening this Pandora's Box at this time. As noted in SIFMA's comment letter to the MSRB regarding the Proposed Rule,[3] however, there are many reasons why orders are not filled and many ways securities can be sold at higher prices in the secondary market that do not require a regulatory response.

The SEC claims that the MSRB's objective "is the broader distribution of municipal securities, rather than the elimination of flipping." The first question this raises is whether it is in the province of the MSRB to determine the preferred order of distributing securities. As noted on the MSRB's website:

> The Board is authorized by Congress to make rules designed-
>
> "to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest."

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[2] It is worth noting, that when the SEC Release summarizes the MSRB's basis for its action, it omits the phrase "at higher prices," no doubt, to support the claim that the Proposed Rule does not intend to preventing flipping.

[3] *See* Comment Letter from Leon J. Bijou, SIFMA, to Peg Henry, Esq., MSRB, (September 11, 2009) (the "MSRB Comment Letter.")

Nowhere does this summary suggest that the MSRB is authorized to assist firms in determining to whom securities should be distributed. If the MSRB wants to prevent fraudulent practices between dealers and issuers, it is already empowered to do so under Rule G-17.

If a broader distribution of securities were the objective of the Proposed Rule, it is unclear why the MSRB would respond to complaints of institutional investors' unfilled orders. It can be argued that helping to ensure that institutional investors' orders are filled would be the antithesis of "a broader distribution of municipal securities."

The MSRB's proposed Interpretive Notice also does not jibe with a motive to support broad distribution of securities. The Interpretive Notice says that the Proposed Rule would not require a syndicate manager to give greater priority to customer orders over orders submitted by dealers who are not members of the syndicate. In other words, the exception to the rule would allow a syndicate manager to give priority to the orders of dealers that are not members of the syndicate over customers' orders. This result, too, contradicts the SEC's claim that the purpose of the Proposed Rule is to encourage a broader distribution of municipal securities.

Finally, it is also worth noting that neither the Proposed Rule nor the MSRB Release suggests that the intent is to have a broader distribution of securities. The wording of the Proposed Rule says that, "*Unless otherwise agreed to with the issuer*, such priority provisions shall give priority to customer orders over orders by members of the syndicate for their own account, orders from affiliates for their own account, or orders for their respective related accounts, *to the extent feasible and consistent with the orderly distribution of securities in the offering* (emphasis added)." That the Proposed Rule would permit issuers to opt out of the newly proposed standard is inconsistent with the purported intent of promoting a broad distribution of securities. Moreover, if a broader distribution of securities is the intent, why does the Proposed Rule refer to "an orderly distribution of securities?" On its face, these are different standards.

It is troubling to us that the SEC Release, the MSRB Release and the Proposed Rule do not agree on the intent of the Proposed Rule. This lack of clarity is carried over in the standards for allocating securities that the Proposed Rule articulates.

The Proposed Rule Presents Standards that are Difficult to Interpret

When read closely, there are several different and, possibly, conflicting, standards that a dealer must take into account under the Proposed Rule without any guidance on how to balance them. The proposed text of Rule G-11(e)(i) is included below (new text is in bold font and underlined):

(e) Priority Provisions.

**(i) In the case of a primary offering for which a syndicate has been formed,** **[**Every**]** **the** syndicate shall establish priority provisions and, if such priority provisions may be changed, the procedure for making changes. For purposes of this rule, the requirement to establish priority provisions shall not be satisfied if a syndicate provides only that the syndicate manager or managers may determine in the manager's or managers' discretion the priority to be accorded different types of orders. **Unless otherwise agreed to with the issuer, such priority provisions shall give priority to customer orders over orders by members of the syndicate for their own account, orders from affiliates for their own account, or orders for their respective related accounts, to the extent feasible and consistent with the orderly distribution of securities in the offering.** Notwithstanding the preceding sentence, a syndicate may include a provision permitting the syndicate manager or managers on a case-by-case basis to allocate securities in a manner other than in accordance with the priority provisions, if the syndicate manager or managers determine in its or their discretion that it is in the best interests of the syndicate. In the event any such allocation is made, the syndicate manager or managers shall have the burden of justifying that such allocation was in the best interests of the syndicate.

**(ii) In the case of a primary offering for which a syndicate has not been formed, unless otherwise agreed to by the issuer, the sole underwriter shall give priority to customer orders over orders for its own account, orders from an affiliate for its account, or orders for their respective related accounts.**

*Issuer's Direction*

Before articulating the new priorities for allocating securities, the introductory provision uses the phrase, "Unless otherwise agreed to with the issuer…." In this manner, the Proposed Rule provides that, if the issuer agrees to an alternative distribution plan, the dealer would not have to give priority to customer orders as provided later in that same sentence.

*An Orderly Distribution of Securities*

The second standard in this provision is the one that applies if the issuer does not agree to an alternative plan of distribution; in that case, the dealer would have to abide by new priority provisions of the Proposed Rule, "to the extent feasible and consistent with the orderly distribution of securities in the offering." The Interpretive Notice does not define what would constitute "the orderly distribution of securities," which is particularly troubling because this is the standard to which dealers, generally, will be held.

The use of the phrase "to the extent feasible and consistent with the orderly distribution of securities in the offering" also raises the question as to whether a dealer could ignore the new priorities, if doing so would result in an orderly distribution of securities. Again, the lack of clarity would make it extremely difficult for a dealer to comply with the Proposed Rule.

*The Bests Interests of the Syndicate*

The third standard is contained in the section of Rule G-11(e) that has not been amended, which says that the syndicate can include a provision permitting deviation from the priority provisions on a case-by-case basis if the syndicate managers "determine that it is in the best interests of the syndicate." Due to inartful drafting, however, when dealers can apply this standard is mired in confusion.

This unamended provision begins with the phrase "Notwithstanding the preceding sentence…." Originally, that segue was to have followed the provision that the requirement to establish priorities would not be satisfied by granting full discretion to the syndicate managers. The "notwithstanding" provision was intended to inform syndicate managers that it is permissible to deviate from the priorities established by the syndicate if doing so is in the best interests of the syndicate.

Instead, as drafted in the Proposed Rule, the "notwithstanding" provision follows the insertion of the new customer priorities provision. On its face, then, the "best interests of the syndicate" standard can be used notwithstanding the new priority provisions, which is not the intended result of the Proposed Rule. This conclusion is supported by a reading of the Interpretive Notice, which does not suggest that the new priorities are to be compared with the "best interests of the syndicate" standard.

In sum, the newly revised Rule G-11(e)(i), at best, is confusing and, at worst, contradictory. It is unfair to subject the dealers to a confusing regulatory regimen that lacks cohesion.

<u>The Effects of the Proposed Rule</u>

According to the SEC, "The MSRB does not believe the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act, since it would apply equally to all dealers." By its own words, however, the MSRB makes it clear that neither proposition is true.

*Detrimental Effect on Competition and Borrowing Costs*

The SEC and the MSRB err in their refusal to acknowledge that the proposed rule would result in higher borrowing costs for issuers. In the Interpretive Notice, the MSRB noted that

"*This principle may affect a wide range of dealers and their related accounts* given changes in organizational structures due to consolidations, acquisitions, and other corporate actions that have, in many cases, resulted in increasing numbers of dealers, and their related dealer accounts, becoming affiliated with one another (emphasis added)."

In SIFMA's comment letter to the MSRB regarding the Proposed Rule,[4] we described how the Proposed Rule will affect on the market:

> If enacted, the proposed amendments would isolate a very large group of active municipal market investors and, because they are affiliated with or related to the syndicate manager, subordinate them to other investors. In creating a tier of second class investors, the proposed amendments would significantly decrease the number of buyers and reduce competition for securities, which could result in issuers paying higher borrowing costs.

As a matter of simple economics, if increasing numbers of dealers are related,[5] under the Proposed Rule that would result in less demand, which would increase the prices paid by issuers to sell their securities.

*Unequal Treatment of Dealers*

The MSRB is also mistaken when it states that the Proposed Rule "would apply equally to all dealers." As noted above, the Interpretive Notice states that dealers who are not members of the syndicate are exempted from the Proposed Rule. As a result, such dealers, with respect to receiving allocations of securities in primary offerings, are at an advantage over dealers who are members of the syndicate.

<u>The Interpretive Notice is Less Restrictive Than the Proposed Rule</u>

In the SEC Release, the SEC rejected the claim made by SIFMA that the Interpretive Notice is more flexible than the Proposed Rule. A careful reading of both the Interpretive Notice and the Proposed Rule, however, supports SIFMA's position.

*Syndicate Dealers*

The main difference between the proposed Rule and the Interpretive Notice appears in the fourth paragraph of the Interpretive Notice, which reads:

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[4] S*ee* the MSRB Comment Letter.
[5] Based on publicly available information, Wells Fargo/Wachovia have nearly 16,000 financial advisors, and each of Morgan Stanley/Smith Barney and Bank of America/Merrill Lynch has more than 20,000 financial advisors.

> Principles of fair dealing *generally* will require the syndicate manager to give priority to customer orders over orders for its own account, orders by other members of the syndicate for their own accounts, orders from persons controlling, controlled by, or under common control with any syndicate member ("affiliates") for their own accounts, or orders for their respective related accounts,[3] to the extent feasible and consistent with the orderly distribution of securities in a primary offering (emphasis supplied).

The greater flexibility of the Interpretive Notice is the result of the word "generally," which was included to indicate that the principles of fair dealing contained in Rule G-17 provide guidance that must take into account all of the circumstances surrounding an allocation of securities in a primary offering and do not compel giving priority to customers' orders. By including the modifier, "generally," the Interpretive Release is less rigorous than the standard articulated in the Proposed Rule. The Proposed Rule, on the other hand, does not contain the word "generally" and, as a result, does not provide the same flexibility as the Interpretive Notice

*Dealers Who Are Not Members of a Syndicate*

The Interpretive Notice is also more flexible than the Proposed Rule for sole underwriters, who are not part of a syndicate. The newly added section, G-11(e)(ii), reads:

> **<u>(ii) In the case of a primary offering for which a syndicate has not been formed, unless otherwise agreed to by the issuer, the sole underwriter shall give priority to customer orders over orders for its own account, orders from an affiliate for its account, or orders for their respective related accounts.</u>**

The phrase "to the extent feasible and consistent with the orderly distribution of securities in the offering" does not appear at the end of this provision, as it does in Rule G-11(e)(i) and in the Interpretive Notice.[6] Unless the issuer otherwise agrees, sole underwriters, then, would need to adhere to the new priority standards without regard for how the securities are distributed. While the definition of "orderly distribution of securities" remains unclear, the absence in the Proposed Rule of the "to the extent feasible" provision makes the Proposed Rule less flexible than the Interpretive Notice.

[6] The Interpretive Notice makes it clear that the principles of fair dealing extend equally to sole underwriters.

Conclusion

We appreciate this opportunity to comment on the Proposed Rule. If you have any questions concerning these comments, or would like to discuss these comments further, please contact me at 212.313.1149 or at lbijou@sifma.org.

Respectfully,

Leon J. Bijou

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cc: ***Securities and Exchange Commission***
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***Securities Industry and Financial Markets Association***
Municipal Executive Committee
Municipal Legal Advisory Committee
Municipal Operations Committee
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Municipal Credit Research, Strategy & Analysis Committee
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