



September 29, 2014

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: **SR-MSRB-2014-07: Notice of Filing of a Proposed Rule Change Consisting of Rule G-18, on Best Execution of Transactions in Municipal Securities, and Amendments to Rule G-48, on Transactions with Sophisticated Municipal Market Professionals ("SMMP"), and Rule D-15, on the Definition of SMMP**

Dear Secretary Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")¹ appreciates the opportunity to comment on the Municipal Securities Rulemaking Board's ("MSRB") filing with the Securities and Exchange Commission ("SEC") Notice of Filing of a Proposed Rule Change Consisting of Rule G-18, on Best Execution of Transactions in Municipal Securities, and Amendments to Rule G-48, on Transactions with Sophisticated Municipal Market Professionals ("SMMP"), and Rule D-15, on the Definition of SMMP (the "Proposal"). SIFMA and our members share the SEC and MSRB's goal of improving the execution standard for the municipal market. Developing a higher standard is in the best interest of investors and the municipal market, and is something SIFMA has been focused on since the SEC issued its Report on the Municipal Securities Market in July 2012² (the "SEC Report" or "Report"). SIFMA supports an execution standard for the municipal market that is structurally similar to FINRA 5310 and we support the execution handling *process* in the Proposal.³

¹ SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

² U.S. Securities and Exchange Commission *Report on the Municipal Securities Market* (July 31, 2012), available at <http://www.sec.gov/news/studies/2012/munireport073112.pdf>.

³ See letter from David L. Cohen, SIFMA, to Lynnette Kelly, MSRB, dated June 24, 2013, available at <http://www.sifma.org/issues/item.aspx?id=8589944578>, proposing an "execution with diligence" standard for the municipal securities market and detailing unique attributes of this market. See also, letter from David L. Cohen, SIFMA, to Ronald W. Smith, SEC, dated October 7, 2013, available at <http://www.sifma.org/issues/item.aspx?id=8589945474>, See also letter from David L. Cohen, SIFMA, to Ronald W. Smith, SEC, dated March 13, 2014, available at <http://www.sifma.org/issues/item.aspx?id=8589947986>.

I. Executive Summary

While SIFMA continues to believe that an execution diligence process resulting in a price that is fair and reasonable under prevailing market conditions is more reflective of the appropriate balance of investor protection interests with the need for efficient municipal markets⁴, we believe that the MSRB has thoughtfully developed and proposed revisions to MSRB Rule G-18 that reflect the unique characteristics of the municipal securities market and warrant certain departures from FINRA 5310. We suggest some slight modifications to the proposed revisions to Rule G-18. SIFMA continues to support the proposed revisions to Rule G-48 that would not extend best execution to transactions with Sophisticated Municipal Market Professionals (“SMMPs”).

Nevertheless, SIFMA has significant concerns regarding the proposed changes to Rule D-15. These concerns include: 1) the lack of public comment by the MSRB on what would be a material change prior to submitting the Proposal to the SEC; 2) the absence of *any* economic analysis on this section; 3) the invalidation of existing SMMP customer affirmations covering modified dealer obligations largely unchanged since 2002; 4) the absence in the Proposal of any discussion of the rationale to invalidate existing SMMP customer affirmations, nor a discussion whether SMMPs had received adequate protection under current Rule D-15; and 5) the operational impact of the deharmonization of the SMMP affirmation process from the FINRA 2111 affirmation process – which just over two years ago the MSRB and SEC agreed merited harmonization.

When the MSRB proposed changes to its SMMP guidance in 2011⁵, the individual MSRB board members had an opportunity to consider comments made by market participants. The rule proposal filed by the MSRB with the SEC was significantly revised and improved⁶. This is a fundamental aspect of Self-Regulatory Organization (“SRO”) rulemaking – SRO board members soliciting public comments and weighing the considered views that are presented. SRO rulemaking without board member reflection of the input of the community it regulates diminishes its legitimacy in the eyes of its stakeholders – dealers, municipal advisors, municipal issuers, and investors. The proposed changes to D-15 will impose additional and unnecessary costs on dealers where no evidence exists, anecdotal or

⁴ We remain very uncomfortable with the use of the phrase “best execution” in multiple instances in the draft rule (including in the title of the rule itself); notwithstanding the MSRB’s statement in the last sentence of Supplementary Material .01, where “the most favorable price possible” will not necessarily be equated with the term “best execution”. We are concerned that regulatory examiners and enforcement staff will use this phrase to enforce standards that are not applicable to the municipal securities market and are inconsistent with the MSRB’s stated intent. In our view, this can be solved by removing the word “best” in certain instances, and replacing “best execution” with “execution diligence” in others.

⁵ MSRB Notice 2011-63 (November 8, 2011) available at <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-63.aspx?n=1>

⁶ See SR-MSRB-2012-05 (March 26, 2012), Restatement of an Interpretive Notice Concerning the Application of MSRB Rule G-17 to Sophisticated Municipal Market Professionals, available at <http://msrb.org/Rules-and-Interpretations/SEC-Filings/~media/Files/SEC-Filings/2012/SR-MSRB-2012-05.ashx>.

substantiated, that the current rule has been applied to institutional customers inappropriately.

Additionally, a twenty day comment period is too short for an issue of first impression to be fully absorbed by the market. The proposed changes to D-15 were unexpected and have significant policy and technology elements to be considered.

Accordingly, SIFMA requests that the SEC move forward with rulemaking regarding Rules G-18 and G-48, and not move forward at this time with the proposed changes to D-15. This would allow the MSRB to solicit public comments directly on the proposed changes to D-15. Implementing the changes to G-18 and G-48 will further the SEC and MSRB's immediate goal of increasing protections for retail investors. Institutional customers would continue to be subject to the same execution standard as they are today. This approach would allow market participants and the MSRB to have a more fulsome discussion of the justification and the merits of the proposed changes to D-15.

II. Background

Soon after the SEC issued the Report, SIFMA began reviewing and discussing the Report and its recommendations. While we believe the municipal market generally operates fairly and efficiently, we also feel strongly that the issues raised in the Report provide an opportunity to improve public trust and confidence in the municipal securities market. We have taken particular notice of issues raised in the Report that suggest that retail customers are disadvantaged in execution, pricing and disclosure as they may not have access to same information as dealers and institutional customers. One recommendation in the Report designed to address this concern is for the MSRB to consider "possible rule changes that would require municipal bond dealers to seek 'best execution' of customer orders [similar to FINRA's approach to corporate fixed income securities]...and provide more detailed guidance to municipal bond dealers on how 'best execution' concepts would be applied in connection with transactions in municipal securities." SIFMA's goals in addressing this recommendation have been to: 1) support effective and efficient regulation of the municipal securities market that aids market liquidity in a manner consistent with investor protection; 2) promote higher standards for brokers, dealers, and municipal securities dealers that would advance public trust and confidence in the municipal securities market; and 3) articulate a principles-based rule that does not favor one execution venue or counterparty over another.

To that end, we have engaged in numerous individual and group meetings with our membership over the past 24 months with the goal of producing a recommended policy change designed to strengthen trade execution in the municipal market. SIFMA's "execution with diligence" proposal was the product of that effort⁷. The MSRB's Proposal reflects numerous suggestions made by SIFMA, as well as those of other commenters.

⁷ See letter from David L. Cohen, SIFMA, to Lynnette Kelly, MSRB, dated June 24, 2013, available at <http://www.sifma.org/issues/item.aspx?id=8589944578>, proposing an "execution with diligence" standard for the municipal securities market and detailing unique attributes of this market

SIFMA believes that the MSRB has thoughtfully developed and proposed revisions to MSRB Rule G-18 that reflect the unique characteristics of the municipal securities market and warrant certain departures from FINRA 5310.

III. Comments on Specific Language in G-18

i. G-18(a)

Among the list of “factors” that will be considered in determining whether a dealer has used “reasonable diligence” is “the number of markets checked⁸”. This factor is more applicable to the equities market structure of exchanges with a central aggregator of bids and offers as well as constant liquidity. A municipal bond trader may seek quotes from other dealers, but depending on the facts and circumstances, doing so may not be in the best interest of the customer as it would permit market participants to become aware of interest in a bond, which could have the effect of moving the market away from the customer. Because the market is generally thinly traded, a fact consistently shown by the MSRB’s own reports, multiple inquiries can alert other participants to interest in selling or buying a bond, causing buyers to lower the price of their bids and sellers to raise the price of their offerings. Further, unlike equity markets, there is no direct continuously-quoted, bid-and-ask trading market between bond dealers in the municipal markets, so the mere act of contacting other dealers for quotes on fixed income securities does not necessarily result in a more timely or beneficial execution. We strongly disagree with any suggestion that the act of contacting other dealers would be the implicit or requisite procedure to evidence best execution.

Further, listing this factor among a non-exhaustive list of factors to be considered by dealers creates a *de facto* enforcement checklist for FINRA. We believe this activity is covered by “the information reviewed to determine the current market for the subject security or similar security”. Additionally listing “the number of markets checked” is inconsistent with the Supplementary Material .04 Definition of Market which acknowledges that a dealer itself as principal may be the best market to satisfy best execution for the subject security. Accordingly, we request that “the number of markets checked” be deleted from proposed Rule G-18(a).

ii. Supplementary Material

Supplementary Material .01 Purpose includes the statement: “A failure to have actually obtained the most favorable price will not necessarily mean that the dealer failed to use reasonable diligence”. SIFMA believes this sentence is a critical part of ensuring that the rule reflects the unique characteristics of the municipal market. Implicit in this language is that best execution does not mean that every trade must match or be at the same price as the trades around it, particularly the trades following. Our members are concerned that

⁸ At most larger dealers, a municipal bond trader has multiple “screens” open at any given time showing, for example, internal inventory, offerings on one or two ATSs, offerings made via constantly scrolling messaging systems, as well as ordinary e-mail. While messages can be retrieved and keystrokes captured, how could a trader *prove* that he or she had actually checked three screens and read two messages as they scrolled by before deciding to execute a purchase for a customer at a particular price?

enforcement regulators will challenge a dealer's trade price because the regulators will have the benefit of hindsight and may be able to show other trades for the same CUSIP at marginally better prices and will assert that the dealer therefore did not provide best execution. We also suggest adding a sentence to codify the MSRB's views contained in SR-MSRB-2014-07 that G-18 was not intended to create a trade-through rule. SIFMA suggests that the following language be added to this section: "A failure to consider a superior price available on another market would not necessarily constitute a violation of the rule".

IV. Proposed Revisions to Rule G-48 (Transactions with Sophisticated Municipal Market Professionals)

The Proposal contains an exemption from best execution for transactions with SMMPs in the form of amendments to Rule G-48. This exemption is consistent with the MSRB's view that "SMMP's typically have as much information regarding the different venues at which a transaction in a municipal security might be executed as most individual dealers."⁹ SIFMA supports this exemption as it is in alignment with the treatment of SMMPs under existing MSRB rulemaking and is consistent with the SEC Report's focus on retail investors and the recommendations to improve market information available to them.

The MSRB first recognized in 2002¹⁰ that their fair practice rules should allow dealers to recognize the different capabilities of certain institutional customers as well as the varied types of dealer-customer relationships. The MSRB has subsequently updated that guidance¹¹ and earlier this year consolidated much of that guidance in the form of MSRB Rule G-48. Since 2002, the MSRB has consistently recognized that "sophisticated municipal market participants" already have access to material information available from established industry sources, which sources were enhanced immeasurably with the creation of the MSRB's Electronic Municipal Market Access (EMMA) system in 2009.

Also in 2002, the MSRB took note of the advent of numerous electronic trading systems, which were efficient trading platforms for broker-dealers and large institutional customers in the case of non-recommended secondary market agency transactions as to which the services of the dealers running those systems had been explicitly limited to providing anonymity, communication, order matching and/or clearance functions. The MSRB's guidance has always been carefully crafted to facilitate such trading efficiencies by applying the SMMP exception for disclosure of material information so as not to render such systems impracticable in the municipal market.

⁹ SR-MSRB-2014-07 at 15.

¹⁰ Interpretive Notice regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals (April 30, 2002), available at <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2002/2002-16.aspx?n=1>,

¹¹ Restated Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals (July 9, 2012), available at <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-27.aspx?n=1>

The creation of a class of sophisticated municipal market professionals led to the development of online trading platforms and improved liquidity and transparency in the municipal market. Indeed, they represent an essential element of the SEC's strategy to extend the concept of regulatory best execution to the municipal market. Yet, the proposed SMMP definition changes have the potential to disrupt this structure. Great care should be taken to make sure that the full effect of the changes to this definition is understood.

V. Proposed Revisions to Rule D-15 (Definition of SMMPs)

In 2011, the MSRB sought to harmonize its definition of SMMP with the FINRA Rule 4512 definition of an institutional account and explicitly advocated for a harmonized compliance regime with FINRA Rule 2111's requirements for institutional accounts – so that a dealer could use a single customer affirmation to satisfy FINRA Rule 2111 and the MSRB's SMMP requirements¹². SIFMA supported this initiative and commended the MSRB for recognizing that reducing the cost of dealer compliance to maintain consistency with FINRA rules is desirable.¹³ This harmonization was important since, prior to the MSRB's proposed SMMP amendments in 2011, the dealer community was well underway in developing compliance regimes to comply with FINRA 2111.

The SEC approved these SMMP harmonized revisions in 2012, only six weeks prior to the effective date of FINRA 2111 (with the requested same effective date). After considerable recent expense to develop and implement FINRA's and the MSRB's harmonized institutional customer compliance regimes, SIFMA's members strongly believe that the proposed changes to MSRB Rule D-15 are a step backwards. We are also disappointed that public comment on these changes was not solicited prior to submission to the SEC for consideration. Further, the filing lacks *any* discussion of an economic analysis on these changes specifically. The costs of maintaining separate affirmation systems for institutional accounts across product lines will be unduly burdensome. Due to the abbreviated comment period for SRO rule filings with the SEC, dealers are still scoping the costs of this aspect of the proposal.

Most alarming is the MSRB's position that a dealer could not treat any customer as an SMMP after the proposed implementation date unless a customer has given the new customer affirmation required under the proposed amendment to Rule D-15 --- even for time of trade disclosures, fair pricing obligations on certain agency transactions, relief from performing a customer specific suitability analysis, and the dissemination of quotations, activity that has been covered by SMMP rulemaking since 2002. It is unclear what the MSRB's rationale is for these changes. The record does not reflect any commenters, SMMP or other, requesting such a change or suggesting that SMMPs were not protected adequately

¹² See SR-MSRB-2012-05 (March 26, 2012) at page 9 (“[R]eceipt by a dealer of the FINRA 2111 affirmation would also satisfy [the SMMP affirmation] requirement”), available at <http://msrb.org/Rules-and-Interpretations/SEC-Filings/~media/Files/SEC-Filings/2012/SR-MSRB-2012-05.ashx>.

¹³ See letter from David L. Cohen, SIFMA, to Elizabeth M. Murphy, SEC, dated May 4, 2012, available at <http://www.sifma.org/issues/item.aspx?id=8589938628>

under current MSRB rules. Additionally, because customers often do not often provide affirmative responses even to repeated requests from dealers, requiring written consent to existing modified transaction pricing obligations on certain agency transactions with SMMPs could represent an interruption of services for customers utilizing certain electronic trading platforms and negatively impact market liquidity.

SIFMA believes that an SMMP customer affirmation that mirrors FINRA's affirmation process as closely as possible makes the most economic sense, encourages cross-over investors, and eases dealer compliance regimes. The modified dealer obligations to SMMPs are well known, and even more so now that they have been codified in the easy to read format of Rule G-48. Institutional customers of a dealer should continue to have the ability to "opt-out" of SMMP treatment, as some of our members have told us that a few institutional customers that meet the SMMP definition have requested to be sent time of trade disclosures. Accordingly, as an alternative to the MSRB's proposed revisions to Rule D-15, SIFMA suggests the following:

MSRB Rule D-15: Sophisticated Municipal Market Professional

The term "sophisticated municipal market professional" or "SMMP" shall mean a customer of a broker, dealer or municipal securities dealer that is:

(1) – (2) [No changes]

(3) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least \$50 million; and,

that the broker, dealer or municipal securities dealer has a reasonable basis to believe is capable of evaluating investment risks, ~~and~~ market value, and execution quality independently, both in general and with regard to particular transactions and investment strategies in municipal securities, and that affirmatively indicates that it is exercising independent judgment in evaluating the recommendations of the broker, dealer or municipal securities dealer.

This proposed language would require dealers to have a reasonable basis to believe that an SMMP would like to avail itself of the conveniences of institutional customer and sophisticated municipal market professional status, which permits the dealer's modified obligations in G-48, individually or collectively.¹⁴ It is their risk to get wrong. Institutional

¹⁴ The Notice of Filing of the Proposal in the Federal Register on September 8, 2014 (the day prior to dealers deadline to "self-report" under the SEC's Division of Enforcement's Municipalities Continuing Disclosure Cooperation Initiative), solicits comment specifically regarding the current and proposed SMMP affirmation process. If the SEC decides to move forward with the changes to D-15 as proposed by the MSRB, some of SIFMA's members agree that the unified affirmation would be much easier to implement and administer, and therefore the preferred alternative. Even if the rule permitted customers to "pick & choose", these members would likely choose to make it all-or-none, and not treat as SMMP for any purpose any customer that did not choose SMMP for all elements, purely because it would be nearly impossible to effectively administer otherwise.

customers could decide that they desire to avail themselves of the protections afforded to non-SMMPs.¹⁵

SIFMA believes that the MSRB's proposed revisions are overly prescriptive – and includes the specificity one might expect if such affirmation was directed to retail customers, not sophisticated market participants. The MSRB seems to be introducing a new category of SMMPs: “sufficiently sophisticated customers”. This limitation is already addressed by the types of customers delineated in Rule D-15 *and* the dealer must have a reasonable basis to believe that such customer is capable of evaluating investment risks and market value independently, as well as indicated that it is exercising independent judgment.

The MSRB's SEC filing, including all public comments received on two MSRB requests for comment, lacks any discussion of the rationale for invalidating existing SMMP customer affirmations after the effective date of the proposed rule changes.

VI. Economic Analysis

In our prior comments to the MSRB, SIFMA raised concerns regarding the adequacy of the MSRB's economic analysis regarding the proposed changes to G-18. We continue to stand at the ready to assist the MSRB fulfill this important element of rulemaking. However, as it relates to the proposed changes to Rule D-15, the MSRB's filing does not discuss any economic analysis. The proposed changes to Rule D-15 fundamentally alter the “how” a dealer determines if a customer qualifies as an SMMP¹⁶. The MSRB's “Policy on the Use of Economic Analysis in MSRB Rulemaking”¹⁷ sets forth four key elements of economic analysis:

1. Identifying the need for a proposed rule and explaining how the rule will meet that need
2. Articulating a baseline against which to measure the likely economic impact of the proposed rule
3. Identifying and evaluating alternative regulatory approaches
4. Assessing the benefits and costs, both quantitative and qualitative, of the proposed rule and the main reasonable alternative regulatory approaches.

¹⁵ Another alternative approach to consider would be similar to a negative consent letter sent to institutional customers under FINRA rules.

¹⁶ The scope of a dealer's modified duties to SMMP's are set forth in Rule G-48. Adding best execution to this list of modified duties was subject to the MSRB's economic analysis contained in MSRB Notice 2014-02.

¹⁷ *Policy on the Use of Economic Analysis in MSRB Rulemaking*, available at <http://www.msrb.org/About-MSRB/Financial-and-Other-Information/Financial-Policies/Economic-Analysis-Policy.aspx>

The MSRB's filing with the SEC does not identify the *need* for the proposed changes to Rule D-15 and does not explain how the proposed changes will meet that need. The filing does not articulate a baseline against which to measure the likely economic impact of the proposed rule. SIFMA believes the baseline to measure the proposed changes against is the current affirmation which is harmonized with FINRA 2111. The filing does not identify or evaluate alternative regulatory approaches. SIFMA has identified two alternative regulatory approaches. Nor does the filing assess the benefits and costs, both quantitative and qualitative, of the proposed rule and the main reasonable alternative regulatory approaches. Due to the abbreviated comment period for SRO rule filings with the SEC, dealers are still scoping the costs of this aspect of the proposal.

The proposed changes to D-15 will have significant impact on the municipal market well beyond best execution – the primary focus of SR-MSRB-2014-07. For this reason alone, the proposed changes to D-15 should not be approved at this time.

VII. Implementation Period

SIFMA supports the one year implementation period for the proposed changes to Rule G-18 and G-48 as recommended by the MSRB. However, if the SEC proceeds with the changes to Rule D-15 as proposed by the MSRB, SIFMA requests an additional six month implementation period for the changes to D-15 (18 months from SEC approval) to allow dealers adequate time to design, build, and test the requisite data feeds, amend and implement policies and procedures, as well as conduct extensive training. And of course seek to obtain the new customer affirmations.

VIII. Conclusion

SIFMA sincerely appreciates this opportunity to comment on the Proposal. SIFMA supports raising the execution standard in the municipal market for retail customers in a way that reflects the current market structure and unique characteristics of the municipal market. We believe that the MSRB has thoughtfully developed and proposed revisions to MSRB Rule G-18 that reflect the unique characteristics of the municipal securities market and warrant certain departures from FINRA 5310. SIFMA also supports the proposed changes to Rule G-48.

Nevertheless, SIFMA has significant concerns regarding the proposed changes to Rule D-15 including: 1) the MSRB not soliciting comments on this section for board member consideration prior to submitting the Proposal to the SEC; 2) the absence of *any* economic analysis on this section; 3) the invalidation of existing SMMP customer affirmations covering reduced dealer obligations largely unchanged since 2002; and 4) the operational impact of the deharmonization of the SMMP affirmation process from the FINRA 2111 affirmation process – which just over two years ago the MSRB and SEC agreed merited harmonization. Accordingly, we urge the SEC not to move forward with the proposed changes to D-15 at this time to allow the MSRB to solicit public comments for its

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board members to consider. In the alternative, we request that the SEC adopt SIFMA's proposed revisions to Rule D-15.

We welcome the opportunity to discuss our comments further with the SEC's Office of Municipal Securities as well as the MSRB.

Please do not hesitate to contact me with any questions at [REDACTED].

Sincerely yours,



David L. Cohen
Managing Director
Associate General Counsel

cc:

Municipal Securities Rulemaking Board
Lynnette Kelly, Executive Director
Gary L. Goldsholle, General Counsel
Michael L. Post, Deputy General Counsel