



MSRB NOTICE 2013-16 (AUGUST 6, 2013)

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## REQUEST FOR COMMENT ON WHETHER TO REQUIRE DEALERS TO ADOPT A "BEST EXECUTION" STANDARD FOR MUNICIPAL SECURITIES TRANSACTIONS

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### INTRODUCTION

The Municipal Securities Rulemaking Board ("MSRB") is requesting comment on whether to require a broker, dealer, or municipal securities dealer ("dealer") to seek "best execution" of customer orders for municipal securities and provide detailed guidance to dealers on how "best execution" concepts would be applied to municipal securities transactions. This request for comment is intended to elicit input from all interested parties on adoption of a "best execution" or similar standard for the municipal securities market, to more fully appreciate the benefits and impact of this requirement on investors and dealers, including the costs, burdens, any operational concerns, as well as any alternatives for the MSRB to consider. Specific comment is also solicited from dealers on the application of their existing best execution requirements to transactions in other types of fixed income securities under FINRA Rule 5310. These comments will assist the MSRB in determining whether to consider undertaking formal rulemaking to propose a best execution or similar requirement on dealers when executing transactions in municipal securities.

Comments should be submitted no later than October 7, 2013, and may be submitted in electronic or paper form. Comments may be submitted electronically by clicking [here](#). Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314. All comments will be available for public inspection on the MSRB's website.<sup>[1]</sup>

Questions about this notice should be directed to Kathleen Miles, Associate General Counsel, at 703-797-6600.

### BACKGROUND

The Securities and Exchange Commission (the "SEC") issued its "Report on the Municipal Securities Market" in the summer of 2012. The SEC Report contained a number of recommendations relating to the structure of the municipal market. Some of the recommendations related to ways in which the MSRB could consider buttressing existing dealer pricing obligations. MSRB rules generally require dealers to trade with customers at "fair and reasonable" prices and to exercise diligence in establishing the market value of municipal securities and the reasonableness of their compensation. However, MSRB rules, unlike rules that apply to the equities and corporate fixed income markets, do not impose a "best execution" standard.

The Commission noted that the lack of such a requirement may give rise to an impression that customers purchasing municipal securities may not be receiving as favorable a price as possible. The Commission has recommended that the MSRB consider a rule that would require dealers to seek "best execution" of customer orders for municipal securities and provide detailed guidance to dealers on how "best execution" concepts would be applied in municipal securities transactions.

The logical starting place for a standard of best execution is FINRA Rule 5310, which applies to both the equity and corporate fixed income markets. In general, FINRA Rule 5310(a)(1) requires a member firm, in any transaction for or with a customer or a customer of another broker-dealer, to use "reasonable diligence" to ascertain the best market for a security and to buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. The rule includes a non-exclusive list of factors that will be considered in determining whether a firm has used "reasonable diligence":

- the character of the market for the security;
- the size and type of transaction;

- the number of markets checked;
- the accessibility of the quotation; and
- the terms and conditions of the order as communicated to the firm.

FINRA Rules 5310(a)(2) and 5310(b)-(e) and the Supplementary Material to Rule 5310 address certain additional obligations of the member firm or standards to be applied if a member firm:

- injects a third party between the member firm and the best available market;
- utilizes the services of a broker's broker;
- staffs an order room or other department to execute customer orders;
- channels customer orders through a third party;
- handles customer orders for securities for which there is limited pricing information or quotations available or securities that do not trade in the United States; or
- receives an unsolicited specific instruction to route a customer's order to a particular market for execution.

The Supplementary Material to Rule 5310 also codifies the obligations of the member firm when it undertakes a regular and rigorous review of the execution quality likely to be obtained from different market centers.

### **EXISTING MSRB PRICING REQUIREMENTS**

MSRB Rule G-18 (Execution of Transactions) and Rule G-30 (Prices and Commissions) generally require dealers to trade with customers at fair and reasonable prices and to exercise diligence in establishing the market value of municipal securities and the reasonableness of dealers' compensation. Rule G-30(a) explicitly provides that the best judgment of the dealer as to the fair market value of the securities at the time of the transaction and of any securities exchanged or traded in connection with the transaction is a relevant consideration. The MSRB issued guidance on the fair-pricing requirements of MSRB Rules G-18 and G-30 in 2004 and addressed the issues relating to the pricing of hard-to-value securities and stressed that "dealers nevertheless should be cognizant of their duty to establish market value as accurately as possible using reasonable diligence" and that "[t]he lack of a well-defined and active market for an issue does not negate the need for diligence in determining the market value as accurately as reasonably possible when fair pricing obligations apply."

### **REQUEST FOR COMMENT**

A "best execution" requirement would augment the existing requirements to trade at prices that are fair and reasonable. While an objective of any "best execution" requirement is to provide a customer with a price that is as favorable as possible under prevailing market conditions, a "best execution" requirement would target the process by which firms handle orders, and as such, would be complementary to existing MSRB Rules G-18 and G-30.

The MSRB, however, is mindful that copying the existing standards from the equity and corporate fixed income markets may not be the optimal manner to promote fair pricing in the municipal market. Although FINRA Rule 5310 applies to fixed income securities, there are certain concepts and requirements in FINRA Rule 5310 that appear more appropriate for equity securities, particularly those that are part of the national market system. The MSRB believes that any "best execution" requirement should be uniquely tailored to the attributes of the municipal securities market. Any divergence from existing best execution requirements would not be intended to dilute them, but to impose requirements that are properly tailored for the municipal market.

Virtually all of the dealers that are registered with the MSRB are subject to the best execution obligations imposed by FINRA Rule 5310 for trades in equities and corporate fixed income securities. This request for comment seeks to leverage the experiences of such firms to assist the MSRB in developing a regime that would improve secondary market pricing of municipal securities.

The MSRB seeks public comment on the following questions, as well as any other comments on this topic, to assist it in determining whether to consider proposing a "best execution" or similar requirement for dealers. The MSRB particularly welcomes statistical, empirical, and other data from commenters that may support their views and/or support or refute the views or assumptions or issues raised in this request for comment. If the MSRB determines to proceed with rulemaking in this area after reviewing the comments received in response to this request for comment, it would publish a request for comment seeking further industry and public input on specific requirements intended to achieve the goals enunciated herein before making a final decision on whether to file such a proposal with the SEC for its approval.

- Would implementation of a best execution requirement help ensure investors receive fair and reasonable prices?
- Are there certain segments of the municipal market or categories of municipal securities for which a best execution requirement would not be appropriate, e.g., transactions in new issues or transactions in variable rate demand obligations?
- Should a best execution requirement apply to all transactions with customers in municipal securities, or should transactions with certain customers, such as sophisticated municipal market professionals (SMMPs) as defined in the interpretation to Rule G-17, on fair dealing, be exempt?
- Would implementing a best execution requirement support compliance by dealers with their fair-pricing obligations to customers? If so, how would the existing requirements for fair pricing be helped by the application of a best execution requirement?
- Do dealers currently follow a “best execution” plan in connection with the purchase or sale of municipal securities?
- Would disclosure that a firm does not utilize a best execution standard be a reasonable alternative to a best execution requirement?
- Should there be a minimum number of quotations that must be received in order to support the prevailing market price established by a dealer?
- If a best execution standard is adopted, how often should the MSRB require that dealers conduct a review of their practices relating to best execution? What factors would be relevant to a determination of whether this review should be more or less frequent?
- Should procedures address circumstances under which dealers might seek quotations from:
  - one or more alternative trading systems?
  - one or more broker’s brokers?
  - one or more affiliates of the dealer’s firm?
  - the dealer firm’s clearing firm?
  - dealer firms that participated in the underwriting of the subject municipal securities?
- How could a dealer be expected to ensure best execution when selling a municipal security to an investor from the dealer’s inventory?
- In the municipal securities market, is it a common practice for customers to direct dealers to solicit bid wanteds from particular dealers, alternative trading systems, or through brokers’ brokers? If not, should dealers be required to provide these alternatives to customers?
- Do customers inquire as to the methods that dealers employ to determine the prevailing market price for municipal securities?
- What are the most significant challenges, if any, currently experienced with interpretation and execution of best execution duties for fixed income securities under FINRA Rule 5310?
- Are there alternative methods that the MSRB should consider to provide more transparency to the process dealers employ when determining the prevailing market price for municipal securities in the secondary market that may be more effective for investors and/or less costly or burdensome to dealers? Would a best execution or similar requirement have any negative effect on the protection of investors and the public interest, or on the fair and efficient operation of the municipal market? If so, please describe in detail.
- What tools do dealers employ to document and preserve diligence undertaken to substantiate the basis of the prevailing market price? What other tools might be needed if a best execution or similar requirement were adopted by the MSRB?
- If your firm conducts a post-trade internal review of pricing, does it audit all trades, a sampling of trades and what frequency is employed for such review, e.g., daily, weekly, monthly or on a quarterly basis?
- If your firm conducts a post-trade internal review, how often does it adjust pricing?

August 6, 2013

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[1] Comments are posted on the MSRB website without change. Personal identifying information such as name, address, telephone number, or email address, will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.

## **Alphabetical List of Comment Letters on Notice 2013-16 (August 6, 2013)**

1. Ambassador Financial Group: E-mail from Allen Collins dated August 8, 2013
2. Barclays Capital Inc.: Letter from Jennifer Small, Municipal Compliance, dated October 7, 2013
3. Bond Dealers of America: Letter from Michael Nicholas, Chief Executive Officer, dated October 7, 2013
4. Financial Services Institute: Letter from David T. Bellaire, Executive Vice President and General Counsel, dated October 7, 2013
5. Interactive Data Corporation: Letter from Mark Hepsworth, President, Interactive Data Pricing and Reference Data, dated October 7, 2013
6. Investment Company Institute: Letter from Tamara K. Salmon, Senior Associate Counsel, dated September 20, 2013
7. J.J.B. Hilliard, W.L. Lyons LLC: Letter from Alex Rorke, Director, Public Finance
8. Melton, Chris: Letter dated September 26, 2013
9. Private Investor: E-mail from Private Investor dated September 2, 2013
10. Securities Industry and Financial Markets Association: Letter from David L. Cohen, Managing Director and Associate General Counsel, dated October 7, 2013
11. Wells Fargo Advisors, LLC: Letter from Robert J. McCarthy, Director of Regulatory Policy, dated October 7, 2013

# Comment on Notice 2013-16

from Allen Collins, Ambassador Financial Group

on Thursday, August 08, 2013

Comment:

In reviewing notice 2013-16 regarding a “best execution” standard, the question that addressed the idea of minimum number of quotations may bring unintended consequences. Depending on the security, the day, the time of day, market conditions, and the client’s wishes, a requirement to obtain multiple quotes in order to determine prevailing market price may impede a client’s ability to get the best price for a bond rather than enhance it. Prevailing market price can be determined within reason through other methods, such as comparable new issue scales and prevailing bid to offer spreads, or recent trades in bonds with similar characteristics. While it is our intent and practice to find as many bids as possible when selling a bond for a client, it has been our experience that a higher number of bids received does not always translate into a fair price for our client. Conversely there have been times when just one bid received was a fair and supportable price. It would be a disservice to an investor to limit access to markets because too few buyers are present to set a prevailing market price, particularly if a market is rapidly going against that investor.

October 7, 2013

Mr. Ronald W. Smith,  
Corporate Secretary  
Municipal Securities Rulemaking Board  
1900 Duke Street, Suite 6000  
Alexandria, VA 22314

Dear Mr. Smith:

Barclays Capital Inc. ("Barclays" or "the Firm") is submitting this letter to the Municipal Securities Rulemaking Board (the "MSRB") in response to the request for comment on MSRB Notice 2013-16, concerning the adoption of a "best execution" or similar requirement on dealers when executing transactions in municipal securities.

The implementation of a best execution standard would support dealer compliance with fair pricing obligations to help ensure investors receive fair and reasonable prices. The existing regulations (MSRB Rules G-18 and G-30) require dealers to trade with customers at fair and reasonable prices and to exercise diligence in establishing the market value of municipal securities and the reasonableness of their compensation. The best execution standard, if implemented, would invariably support existing fair pricing obligations, ideally by addressing the process by which firms handle orders in order to provide customers with a price that is as favorable as possible under prevailing market conditions.

Taking into account the additional sensitivity surrounding the trading environment for municipal securities, the MSRB should fully leverage the industry's current framework for compliance with FINRA Rule 5310 (Best Execution and Interpositioning) ("Rule 5310"), rather than create an additional and inconsistent set of standards. In complying with Rule 5310, industry firm policies likely already require that traders must use best efforts to attempt to gain the best price for the client in all cases by consulting all available sources and assessing the market through other dealers, benchmark indices, similar bonds, and market environments.

The current industry framework applied to compliance with Rule 5310 also encompasses conducting post-trade internal reviews for potential transactions that may require price improvements. Internal or third-party vendor systems generate alerts on such transactions for further analysis. These alerts are reviewed on a daily basis and are addressed via closeout comment or price adjustment. Many firms currently apply this post-trade review process across all products, including those not covered by Rule 5310, to ensure best execution for their clients.

While the adoption of a best execution standard ultimately benefits the municipal securities market, there are circumstances and transactions where this requirement may be inappropriate due to the nature of the business. While we attempt to always ensure best execution for our clients, there may be instances where this may be of limited value, for example:

- Transactions in new issues
- Transactions in variable rate demand obligations and short term securities
- Transactions with sophisticated municipal market professionals (SMMPs)

Furthermore, implementation of a best execution rule does give rise to some concerns regarding the exacerbation of an already decentralized and relatively illiquid municipal securities market. The Firm suggests delineating pricing and documentation methodologies in the proposed best execution requirement by categories of securities rather than by factors used to determine best execution as listed in FINRA Rule 5310.<sup>1</sup> Suggested categories are:

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<sup>1</sup> A non-exhaustive list of considered factors include: the character of the market for the security, the size and type of transaction, the number of markets checked, the accessibility of the quotation, and the terms and conditions of the order as communicated to the firm.

- Investment grade, fixed rate bonds
- Bonds in which a firm makes markets in
- Illiquid bonds
- Distressed bonds
- Distressed market conditions

These methodologies, however, should not be so prescriptive as to dictate a minimum number of quotations that must be received in order to support the prevailing market price by a dealer. The method the broker uses to purchase or sell a municipal security for its customer can materially impact the price and timeliness of the transaction.<sup>2</sup> For example, a dealer may be able to quickly sell (purchase) a municipal security from (into) its inventory, providing the customer certainty of execution, but this may come at the expense of a better price that might be obtained if the customer's order were exposed to competition.<sup>3</sup> Nuanced scenarios are all too common, especially in illiquid and distressed markets, and may require a dealer to use his or her best judgement as opposed to following generic procedures in order to provide best execution for a client.

If a best execution standard is indeed rolled out, firms would establish new practices by way of enacting new compliance policies and written supervisory procedures, as well as implementing additional monitoring and surveillance. This additional surveillance element would incur costs related to the adoption (and perhaps creation) of new technology systems. Moreover, review of practices related to best execution should occur on a periodic basis. Such reviews may also occur on an ad hoc basis should there be a material change that affects the firm's ability to obtain the best possible result for execution of client orders.

Finally, the Firm would like to provide additional suggestions regarding the adoption of a best execution standard.

- Consolidation of existing fair pricing rules (MSRB Rules G-18 and G-30) with the proposed best execution requirement: A dealer's fair pricing obligation ("to obtain a price for the customer that is 'fair and reasonable' in relation to the prevailing market conditions"<sup>4</sup>) seems to be at slight odds with the objective of a best execution requirement ("to provide a customer with a price that is 'as favorable as possible' under prevailing market conditions"<sup>5</sup>). A best execution requirement would seemingly always satisfy the fair pricing obligation, but a fair and reasonable price does not always satisfy a best execution requirement. In the latter case, the MSRB should clarify whether best execution requirements supersede fair pricing obligations. As such, a consolidation of the two requirements might eliminate any potential redundancies and ambiguities.
- Enhanced search capabilities on the MSRB's EMMA website: As a method of increasing price transparency, the MSRB should consider adding filters to allow EMMA users to search for recent prices of comparable securities. Possible search parameters could include type of bond, type of issuer, price, yield, credit rating, maturity date, coupon rate, tax treatment, call feature, credit enhancement, etc.

Barclays appreciates this opportunity to comment on MSRB Notice 2013-16. If you have any questions or require additional information, please contact Jennifer Small at 212-526-3765, or e-mail our mailbox at: [MuniCompliance@barclays.com](mailto:MuniCompliance@barclays.com).

Sincerely,

Jennifer Small  
Municipal Compliance

Direct line: 212-526-3765  
[jennifer.l.small@barclays.com](mailto:jennifer.l.small@barclays.com)

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<sup>2</sup> Securities and Exchange Commission's "Report on the Municipal Securities Market" (2012), p.146

<sup>3</sup> See note 2

<sup>4</sup> MSRB Rule G-30 Prices and Commissions

<sup>5</sup> MSRB Notice 2013-16

October 7, 2013

VIA ELECTRONIC MAIL

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

*RE: MSRB Notice 2013-16 (August 6, 2013) – Request for Comment on whether to require Dealers to adopt a “Best Execution” standard for municipal securities transactions*

Dear Mr. Smith:

On behalf of the Bond Dealers of America (“BDA”), I am pleased to submit this letter in response to Municipal Securities Rulemaking Board (“MSRB”) Notice 2013-16 (“Notice”) seeking comments on whether to require a broker, dealer, or municipal securities dealer (“dealer”) to seek “best execution” of customer orders for municipal securities and provide detailed guidance to dealers on how “best execution” concepts would be applied to municipal securities transactions.

BDA is the only DC-based group representing the interests of middle-market securities dealers and banks focused on the U.S. fixed income markets. Accordingly, we believe that we uniquely offer insight into how a best execution rule would impact the middle-market securities dealers who provide essential liquidity to the municipal securities through their specialization of regional and unique credits.

***General.***

We are concerned that “cutting and pasting” FINRA Rule 5310 into the MSRB rules could cause more damage than good. The application of FINRA Rule 5310 depends on trading venues in which there are multiple quotations on centralized trading platforms that are not present given the characteristics of the municipal securities market. While there are electronic trading platforms that are increasingly important in the trading of municipal securities, the municipal securities market relies upon the willingness of dealers to develop an inventory of municipal securities to meet the trading needs of their customers.

Unlike the equity and corporate bond markets, municipal securities are highly diverse in the varying kinds of issuers, kinds of credits, sizes of issuers and credit quality. Much of the trading activity by regional dealers relies upon local knowledge; on one hand,



relatively few states do the majority of all bond issuances and their credits are well-known – and on the other hand, the vast majority of states and localities have a low frequency of issuance that relies upon specialized, local knowledge. In addition, it has been the experience of companies with internal requirements for a minimum number of bids that they cannot meet that standard for all bonds and can find only one bid. Further, it is well documented that municipal securities trade very infrequently relative to other markets.

Accordingly, the municipal securities market depends on dealers who are willing to develop and carry inventories of municipal securities as that “venue” where municipal securities are traded. Any rule that penalizes or dis-incentivizes a dealer from engaging in the business of carrying an inventory for that purpose, such as a rule that artificially forces dealers into a particular trading venue, could see an exit of dealers from the market and thereby adversely impact liquidity and pricing of municipal securities more generally. This would defeat the entire purpose of a best execution rule.

Dealers already must comply with a host of fair pricing and suitability rules that protect the pricing customers receive on trades. Where dealers effect their trades in the municipal securities market has much less to do with what pricing a customer receives than the proper diligence of a dealer in ensuring that customers received a fair and reasonable price. We believe that the rules that are going to protect the pricing customers receive will be the MSRB’s fair pricing and suitability rules and we do not believe that new rules that govern where dealers effect their trades will materially improve that pricing.

We are particularly concerned with any application of a best execution rule to sales by dealers of municipal securities, as opposed to purchases. This is particularly the case for bonds that trade infrequently or instances in which only one dealer may own or bid for unique bonds that relies upon local knowledge. Moreover, retail customers generally do not ask to purchase specific securities and instead ask for types of securities and even for help in deciding what kinds of securities would be suitable for them to purchase. Accordingly, “best execution” rules that would govern those trades, in the sense of governing where the dealers effect those trades, makes no sense. Fair pricing standards, already imposed by Rules [G-18](#) and [G-30](#), help ensure that customers, including retail customers, are treated fairly in the municipal markets -- and those standards apply whether bonds are being purchased or sold by dealers. Enhancements to fair pricing standards could be viewed as a companion to a best execution rule that is imposed upon dealers with respect to the purchase of bonds.

Further, the point of the retail business of the dealer in the municipal securities market is to develop an inventory of municipal securities that meets the needs of its customers. If dealers cannot use their inventories to meet their customers’ needs, the dealers will have no incentive or purpose in developing those inventories. Thus, a best execution rule governing sales by dealers of municipal securities could dry up important sources of liquidity in the municipal securities market, which in turn could worsen not improve pricing of municipal securities.

### *What execution rule could the MSRB fashion?*

We think it makes sense for the MSRB to adopt a rule that ensures that dealers are taking proper steps whenever they purchase municipal securities from a retail customer. With any purchase of municipal securities from a retail customer, a dealer needs to make a good decision concerning whether it should seek bids from other dealers, trade the securities through an electronic trading platform, use a broker's broker or purchase the securities into their inventory. We believe that it is important for dealers to make these decisions in a systematic and careful manner.

*What would the rule say?* Accordingly, we recommend that the MSRB develop a new rule (the "Potential Execution Rule") that would require dealers to develop policies and procedures that ensure that they (1) routinely evaluate the potential venues and manners of execution of any purchase of municipal securities for a retail customer and (2) develop a systematic process to ensure that they avail themselves of those venues and manners of execution of purchases of municipal securities for retail customers that are most likely to produce the best prices for customers. Any Potential Execution Rule should be clear that, in developing its policies and procedures, dealers should take all options into consideration, including alternate trading systems, the use of broker's broker and other dealers. In addition, dealers should also take into consideration how different securities may warrant different manners of execution. For example, municipal securities issued by larger issuers tend to be easier to trade on alternate trading systems whereas municipal securities issued by smaller or more obscure issuers may need to be traded with dealers specializing in those kinds of credits. The point is that proper execution of trades depends largely on the kind of securities that are being traded and there is really no venue or collection of venues that represents the "right venue" for all securities.

*Some areas the MSRB should be clear about in fashioning any Potential Execution Rule.* In presenting the Potential Execution Rule for your consideration, we do think that the MSRB should be careful to be clear about a few things.

- *Any Potential Execution Rule should just impose on dealers the obligation to adopt and maintain a policy.* We are concerned that any execution rule should not impose a trade-by-trade obligation on the part of dealers. As a practical matter, the only way by which dealers could comply with any execution rule is to adopt a reasonable policy and regularly review that policy. Accordingly, we believe that this should be the rule and that we should not later find out that FINRA examinations take a different course in which dealers are forced to justify why they traded securities where they did on a trade-by-trade basis. Given the dispersed nature of the municipal securities market, any trade-by-trade obligation in retrospect is essentially impossible to comply with and does not yield meaningful information and therefore the MSRB should be sure to be clear that it is not imposing such an obligation.
- *SMMPs should be excluded from coverage of Potential Execution Rule.* The whole impetus of an execution rule is to improve the trading of

securities for retail customers. Sophisticated municipal market professionals (“SMMPs”) have as much access to trading venues and other dealers as the dealers themselves. Often times, SMMPs develop relationships with several dealers to allow the SMMPs the ability to measure the market for themselves. SMMPs are simply not in need of the protection of an execution rule and thus should be excluded.

- *Use the existing structure of Rule G-27 to monitor compliance by dealers of the Potential Execution Rule.* Our most significant concern with how any execution rule would operate in the municipal securities market is how examiners in the field will interpret the rule. Accordingly, we think that the MSRB needs to rely on Rule G-27 to address the on-going monitoring of compliance with any execution policies and procedures. We want to be sure that dealers do not end up with the burden of documenting why they choose particular venues on a trade-by-trade basis.

Thank you for the opportunity to submit these comments on the Notice.

Sincerely,

A handwritten signature in blue ink that reads "Michael Nicholas". The signature is written in a cursive, flowing style.

Michael Nicholas

Chief Executive Officer

## VIA ELECTRONIC MAIL

October 7, 2013

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

**Re: MSRB Notice 2013-16: Request for Comment on Whether to Require Dealers to Adopt a “Best Execution” Standard for Municipal Securities Transactions**

Dear Mr. Smith:

On August 6, 2013, the Municipal Securities Rulemaking Board (MSRB) published its request for public comment on whether to require a broker, dealer, or municipal securities dealer (collectively “dealers”) to seek “best execution” of customer orders for municipal securities and provide detailed guidance to dealers on how “best execution” concepts would be applied to municipal securities transactions (Request for Comment).<sup>1</sup> The MSRB is also seeking specific comment from dealers on the application of their existing best execution requirements to transactions in other types of fixed income securities under FINRA Rule 5310. The purpose of the Request for Comment is to elicit input on the benefit and impact of this requirement including the costs, burdens, any operational concerns, as well as any alternatives for the MSRB to consider.

The Financial Services Institute<sup>2</sup> (FSI) appreciates the opportunity to comment on this important proposal. In principle, FSI supports MSRB efforts that will provide retail investors with better execution and more fair and efficient pricing for municipal securities. However, we foresee several challenges in implementing best execution in the municipal securities market due to the semi-active liquidity, diversity, and fragmentation in the market. A proposal that properly balances the laudable goals with the accompanying challenges must be properly vetted and would require an extended comment and implementation period to develop and test. We provide preliminary thoughts on addressing these concerns and challenges, and look forward to offering additional comments to any MSRB proposed rule in the future.

### Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in

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<sup>1</sup> Request for Comment on Whether to Require Dealers to Adopt a “Best Execution” Standard for Municipal Securities Transactions, MSRB Notice 2013-16, available at: <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-16.aspx?n=1>.

<sup>2</sup> The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has over 100 Broker-Dealer member firms that have more than 138,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 35,000 Financial Advisor members.

the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisers are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 independent financial advisers – or approximately 64 percent of all practicing registered representatives – operate in the IBD channel.<sup>3</sup> These financial advisers are self-employed independent contractors, rather than employees of the IBD firms. These financial advisers provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisers are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisers affiliated with IBDs is comprised of clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisers are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.<sup>4</sup> Independent financial advisers get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisers have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisers. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisers play in helping Americans plan for and achieve their financial goals. FSI's primary goal is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

#### Comments

FSI appreciates the opportunity to provide a response to the Request for Comment. While a best execution standard for municipal securities can provide benefits to retail investors, the implementation of this standard to the municipal securities market presents a variety of challenges. We also urge the MSRB to make full use of its recently adopted Policy for Integrating Economic Analysis in MSRB Rulemaking in pursuing a best execution standard.<sup>5</sup> We believe that the approach to cost-benefit analysis described in the adopted policy represents a very high quality commitment to additional transparency and more effective rulemaking. FSI supports regulatory initiatives that enhance transparency and improve pricing for retail investors, and we look forward to providing further comment in the event that the MSRB advances a specific proposal that achieves the promise of best execution while avoiding the pitfalls. In the meantime, we provide the following thoughts:

- **Approach must be process-based:** A proposed rule with regard to best execution should be process-based. Because of the unique characteristics of the municipal securities market, a number of factors must be weighed in establishing whether a dealer has fulfilled his or her obligations to the customer. Because the market for municipal securities lacks the systemized infrastructure for equity markets (Reg NMS, for example), pricing alone cannot serve as the prime factor when assessing whether a dealer has fulfilled his or her obligation. Recognizing this reality, we

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<sup>3</sup> Cerulli Associates at <http://www.cerulli.com/>.

<sup>4</sup> These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisers.

<sup>5</sup> Municipal Securities Rulemaking Board, “Policy on the Use of Economic Analysis in MSRB Rulemaking,” available at <http://msrb.org/About-MSRB/Financial-and-Other-Information/Financial-Policies/Economic-Analysis-Policy.aspx>.

encourage the MSRB to develop a specific and tailored process that identifies when and whether a dealer has complied.

- **“Execution-with-diligence” standard:** SIFMA’s Recommendation to Improve Customer Execution<sup>6</sup> through an “execution-with-diligence” standard reflects a thoughtful and reasonable approach to alleviating many challenging issues with respect to implementation of a best execution standard in the municipal securities market. The framework advanced in the Recommendation contains a non-exhaustive list of factors that would be considered when determining whether a dealer has used “reasonable diligence” with respect to customer execution of municipal securities. Such an approach properly balances the concerns for additional transparency while recognizing the unique characteristics of the municipal securities market and their accompanying challenges.
- **Extended development process:** Because of the many challenges accompanying this proposal, we suggest the MSRB provides an extended comment period and implementation period. Industry participants will require sufficient time and resources to properly review the impacts and procedures required to comply with any proposed rule. We recommend a period of at least 12 months for the implementation period and 90 days for the comment period.

#### Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with the MSRB on this and other important regulatory efforts.

Thank you for your consideration of our comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. T. Bellaire". The signature is fluid and cursive, with a large initial "D" and "T" and a stylized "Bellaire".

David T. Bellaire, Esq.  
Executive Vice President & General Counsel

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<sup>6</sup> Securities Industry and Financial Markets Association, “SIFMA Submits Recommendation to the MSRB on ‘Execution With Diligence’ Standard for Municipal Trading,” available at <http://www.sifma.org/issues/item.aspx?id=8589944578>.



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October 7, 2013

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

Re: MSRB Notice 2013-16

Dear Mr. Smith:

Interactive Data appreciates the opportunity to respond to the MSRB's request for comment on whether to adopt a "best execution" standard for dealers executing customer orders for municipal securities. As explained in greater detail below, we believe that high-quality evaluated pricing for municipal securities from independent sources represents an important input into the processes that a dealer may utilize to determine whether a best execution standard has been met. Accordingly, should the MSRB propose a best execution rule, we believe that it should provide guidelines that support the use of evaluated pricing when evidencing best execution.

**Background on Interactive Data Corporation:**

Interactive Data Corporation is a leader in financial information. Thousands of financial institutions, including many of the world's leading investment companies, subscribe to our fixed income evaluated pricing, reference data, real-time market data, trading infrastructure services, fixed income analytics, desktop solutions and hosted, web-based solutions. Interactive Data's offerings are used to assist clients with mission-critical functions, including portfolio valuation, regulatory compliance and risk management.

For over 40 years, Interactive Data's Pricing and Reference Data business has been collecting, editing, maintaining, and delivering financial data, and has established itself as a leading provider of evaluated pricing for 2.8 million fixed income securities, international equities and other hard-to-value instruments including OTC derivatives. In recent years, we have invested considerable resources to expand our coverage and provide our clients with greater insight and transparency into the inputs used to derive our evaluated prices, as well as help automate and streamline key valuation processes. These offerings are complemented by a comprehensive range of reference data for more than 10 million securities encompassing listed markets pricing, identification information, corporate actions, and terms and conditions for current and historical fixed income securities.

We have long supported our clients' mission-critical activities in the municipal securities markets. In particular, Interactive Data currently delivers evaluated pricing on more than 1.1 million municipal securities and our descriptive reference data on this asset class covers over 4.6 million municipal securities.<sup>1</sup> These capabilities are complemented by best-in-class fixed income portfolio analytics.

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<sup>1</sup> Interactive Data's reference data coverage counts include instruments that are available in Interactive Data services, some of which may have matured or otherwise be inactive.

Interactive Data Pricing and Reference Data has built a strong presence within the U.S. mutual fund marketplace and currently counts 50 of the top 50 U.S. mutual fund companies as customers as well as 10 of the top 10 custodian banks, 48 of the 50 largest U.S. banks and 32 of the top 50 hedge funds.

## **Interactive Data’s Perspective on Evaluated Pricing as it Relates to Best Execution:**

Should the MSRB determine that adopting a best execution standard would further promote a fair and efficient municipal market, we believe that such a standard would be strengthened by incorporating the concept that high-quality evaluated pricing for municipal securities from independent sources can be an important input to validate best execution. In particular, our positions below can be viewed in the context of the MSRB’s request for comments on tools that dealers could employ to document and preserve diligence undertaken to substantiate the basis of the prevailing market price:

- ***Established MSRB and FINRA Rules Validate the Importance of Independent Pricing:*** Existing MSRB guidance outlines some of the challenges surrounding the pricing of bonds, particularly hard-to-value securities. We believe that it is appropriate to reflect these key concepts as part of a potential best execution rule. For example, as stated in the request for comment, current MSRB rules G-18 and G-30 establish requirements for dealers to trade with customers at fair and reasonable prices, and to exercise diligence in establishing the market value of municipal securities, including issues relating to the pricing of hard-to-value securities. In addition, MSRB rule G-43 outlines, among other things, how objective pricing criteria (which could include evaluated pricing services) is required to support the predetermined parameters of a broker’s broker as part of its efforts to obtain a price for the dealer that is fair and reasonable in relation to prevailing market conditions.<sup>2</sup> Additionally, we believe that certain concepts within FINRA Rule 5310, including those covering “orders involving securities with limited quotations or pricing information” are relevant for consideration by the MSRB in terms of how evaluated pricing can be used to support best execution compliance for corporate and other fixed income securities.<sup>3</sup>
- ***The Municipal Securities Market is Likely to Remain Thinly Traded:*** We believe an important aspect of a potential best execution rule concerns the overall liquidity of the municipal securities marketplace. While we applaud the steps that the MSRB has taken to bring new pre- and post-trade transparency to the municipal securities market in recent years, the reality is that the municipal market remains thinly traded. For example, in 2011, there were 41,257 trades on just 15,217 unique securities.<sup>4</sup> This implies that less than 2% of the potential universe traded that year (based on over one million different municipal bonds outstanding as of December 31, 2011<sup>5</sup>), and that most of the bonds traded in the secondary market traded fewer than three times per year. While we are optimistic that future MSRB’s initiatives can increase transparency and thereby help improve liquidity to a certain extent, it is not realistic to think that the trading activity in this market will transform into anything

<sup>2</sup> <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-43.aspx?tab=2>.

<sup>3</sup> [http://finra.complanet.com/en/display/display\\_viewall.html?rbid=2403~element\\_id=3031&element\\_id=10455&print=1](http://finra.complanet.com/en/display/display_viewall.html?rbid=2403~element_id=3031&element_id=10455&print=1).

<sup>4</sup> [http://www.msrb.org/msrb1/pdfs/MSRB-FactBook-2012\\_WEB.pdf](http://www.msrb.org/msrb1/pdfs/MSRB-FactBook-2012_WEB.pdf), page 39.

<sup>5</sup> <http://www.sec.gov/news/studies/2012/munireport073112.pdf>, page i.



resembling the liquidity of U.S. equity markets. As a result, there will continue to be an extensive range of municipal securities without readily available or reliable market quotations. In such cases, evaluated pricing can be an important input into the processes that a dealer may utilize to determine whether a best execution standard has been met.

- ***High-Quality Evaluated Pricing from Independent Sources Typically Takes Multiple Sources into Account and Helps Mitigate Conflicts of Interest:*** Interactive Data's bond evaluation techniques reflect market participants' assumptions and maximize the use of relevant observable inputs including quoted prices for similar assets, benchmark yield curves, credit and market corroborated inputs. Further, by incorporating information from both the buy-side and the sell-side whenever possible, we take a balanced view into the trading-related activity for a given security. The independence of such pricing information is another important, related concept. While we recognize that the input of a firm's traders or portfolio managers is very valuable, overreliance on the perspective of a firm's front office professionals is fraught with conflict. Accordingly, we believe that the use of evaluated pricing helps firms safeguard investor interests and develop appropriate oversight controls.
- ***Evaluated Pricing Capabilities are Advancing:*** Evaluated pricing vendors like Interactive Data are investing aggressively to keep pace with the continued evolution of the fixed income markets. For example, we are implementing continuous pricing processes and expanding our range of real-time fixed income pricing services to include real-time fixed income evaluated pricing.<sup>6</sup> We believe that real-time evaluated fixed income pricing will be a significant advancement for the industry, further extending the use of our evaluated pricing in a variety of pre-trade activities<sup>7</sup> including those involved with supporting best execution compliance.

We also believe that the evolution of public reporting of fixed income transactions can provide valuable information that can further inform both institutional and retail market participants. More specifically, we worked with a prominent academic authority to jointly publish research on trading costs for large and small trades in the corporate and municipal bond markets.<sup>8</sup> We believe this analysis, which was made possible by the MSRB's addition to EMMA of the direction of trade variable (or reporting party side variable), can be used to develop additional valuation services that support a firm's compliance with best execution on behalf of its retail clients.

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<sup>6</sup> <http://www.interactivedata.com/prdetail.php?pr=315>.

<sup>7</sup> Interactive Data plans to submit a response to the MSRB's Concept Release on Pre-Trade and Post-Trade Pricing Data Dissemination through a New Central Transparency Platform.

<sup>8</sup> <http://www.interactivedata.com/uploads/File/2010-Q4/prd/WhitePaper-201008.pdf>.

- **Valuation Transparency Tools Can Also Support Best Execution:** Given the current trading and liquidity dynamics of the municipal securities market, we believe that further enhancements to pre- and post-trade market transparency can further support compliance with a best execution mandate. However, it is important to balance the benefits associated with improved access to data against the risks of enabling investors to rely on information that may be of dubious quality or offering so much information that it may confuse investors or otherwise become too challenging to integrate and process –any or all of which can be detrimental to trading, valuation and related compliance activities.

The approach we have taken to evolve our services and provide the industry with new levels of transparency into our evaluated pricing is one that we believe can be used to support best execution compliance. For example, Interactive Data’s Vantage<sup>SM</sup> web application enables clients to visualize Interactive Data’s evaluated prices within the context of a broad range of relevant market information, including public and proprietary market data inputs used in the evaluated pricing process.<sup>9</sup> This market context and insight helps clients address regulatory and accounting driven concerns about their valuation processes, and is already helping clients with FINRA Rule 5310 compliance activities. In particular, Vantage supports best execution compliance-related workflows through:

- Analysis of actual trade data – Clients can examine the size of the trade, the side of the trade, the timing of the trade and the direction of the trade.
- Access to issuer data – When trade activity in a particular issue is limited, Vantage provides access to activity in other securities from that same issuer.
- Additional market color – Vantage provides insight into quotes, enabling clients to compare this information against actual trade activity.
- Comparable securities –Clients can view a range of comparable securities so that clients can view the market activity for similar issues.
- Workflow – By combining these various components into a single display and enabling the creation of time-sensitive reports, clients can use Vantage to reduce manual efforts and streamline validation workflows.

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<sup>9</sup> For more information about Vantage, please visit <http://www.interactivedata.com/VantageEvaluatedPricing/>.



## Summary

Interactive Data appreciates the opportunity to comment on the potential adoption of a best execution standard for dealers involved in municipal securities transactions. We believe that evaluated pricing from independent sources can be an important tool for dealers to consider in supporting their best execution analysis. We believe that third-party valuation service providers like Interactive Data will continue to play an important role in helping participants in the municipal securities market value securities, and comply with a wide range of regulatory requirements. Accordingly, we look forward to working with the MSRB and the broker/dealer community on this important issue.

Sincerely,

A handwritten signature in black ink that reads "Mark Hepsworth".

Mark Hepsworth  
President, Interactive Data Pricing and Reference Data  
Interactive Data Corporation



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202/326-5800 www.ici.org

September 20, 2013

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

Re: MSRB Notice 2013-15 and 2013-16  
Relating to Fair Pricing Proposals

Dear Mr. Smith:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to respond to the requests of the Municipal Securities Rulemaking Board (MSRB) for comments on two proposals relating to fair pricing of municipal securities. MSRB Notice 2013-15 proposes a new fair-pricing rule that would consolidate existing rules and guidance. MSRB Notice 2013-16 seeks comment on whether the MSRB should require dealers to comply with a “best execution” standard for “municipal securities transactions.”<sup>2</sup> To the extent the MSRB determines to adopt rules relating to fair pricing and/or best execution, we strongly recommend that it expressly limit the scope of such rules to municipal securities other than municipal fund securities that are 529 college savings plans.<sup>3</sup> As discussed in more detail below, this recommendation is appropriate because the manner in which municipal fund securities are priced and sold to the public differs significantly from that for other municipal securities. It also is consistent with our previous recommendation

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<sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$15.4 trillion and serve over 90 million shareholders.

<sup>2</sup> See *Request for Comment on Proposed Fair Pricing Rule*, MSRB Notice 2013-15 (Aug. 6, 2013) and *Request for Comment on Whether to Require Dealers to Adopt a “Best Execution” Standard for Municipal Securities Transactions*, MSRB Notice 2013-16 (Aug. 6, 2013) (“fair pricing proposals”).

<sup>3</sup> As used in this letter, the reference to “municipal fund securities” is intended to mean securities of a 529 college savings plan.

that the MSRB better clarify whether an MSRB rule or rule proposal that is applicable to “municipal securities” is intended to apply to “municipal fund securities.”

#### **THE PRICING OF MUNICIPAL FUND SECURITIES**

As the MSRB is aware, municipal securities that are government-issued bonds trade at prices negotiated by the parties to the transaction. By contrast, municipal fund securities (such as interests in 529 college savings plans) are priced in a manner similar to mutual funds<sup>4</sup> — *i.e.*, their price is based on the current value of the investments in the plan minus plan expenses, and transactions are effected at that price, subject to any applicable sales charges or account fees, all of which must be disclosed to investors to avoid running afoul of the antifraud provisions of the Federal securities laws.

Given these pricing differences, it appears obvious that the proposals under consideration are not relevant to municipal fund securities transactions.<sup>5</sup> Indeed, because of this irrelevance, we presume the MSRB did not contemplate applying these proposals to municipal fund securities transactions. However, because the proposals are entirely silent on municipal fund securities, by their terms, they would appear to apply to the sale *all* of municipal securities, including interests in 529 plans and other municipal fund securities. In light of the significant differences in the pricing and execution of transactions in municipal fund securities vis-à-vis those involving other types of municipal securities and for the sake of clarity, we urge the MSRB to expressly exclude municipal fund securities from the fair pricing rules and the consideration of a best execution requirement. If, instead, the MSRB does intend these notices to apply to transactions involving municipal fund securities, we strongly recommend that the MSRB clarify their meaning in the context of municipal fund securities.

#### **DISTINGUISHING MUNICIPAL FUND SECURITIES FROM OTHER MUNICIPAL SECURITIES**

The Institute’s recommendation to limit the application of its proposed fair pricing proposals to those municipal securities that are not municipal fund securities is consistent with previous comments we have made to the MSRB recommending that the MSRB clearly indicate which of its rules and rule proposals are, and are not, intended to

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<sup>4</sup> MSRB Rule D-12 defines a “municipal fund security” as “a *municipal security* issued by an issuer that, but for Section 2(b) of the Investment Company Act of 1940, would constitute an investment company within the meaning of Section 3 of the Investment Company Act of 1940.” [Emphasis added.]

<sup>5</sup> For example, Proposed Supplementary Material .02, relating to Relevant Factors in Determining the Fairness and Reasonableness of Prices, provides that “the most important factor in determining whether the aggregate price to the customer is fair and reasonable is that the yield should be comparable to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market.” Significantly, this “most important factor” is wholly irrelevant to the price paid by an investor purchasing a municipal fund security.

Ronald W. Smith, Corporate Secretary

September 20, 2013

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apply to municipal fund securities. As we stated most recently to the MSRB in February 2013:

. . . as a technical matter, the term “municipal security” includes *both* municipal fund securities and other municipal securities. Indeed, persons selling municipal fund securities are required to abide by all rules applicable to municipal securities as well as all rules applicable solely to municipal fund securities. (By contrast, persons selling municipal securities are only required to comply with rules relating to municipal securities.) We strongly recommend that the MSRB (1) adopt a definition of the term “municipal security” (or a similar term) that refers exclusively to non-municipal fund securities and (2) clarify within each of its current and future rules and guidance whether such rule or guidance applies solely to municipal fund securities, solely to municipal securities other than municipal fund securities, or to both.

Should the MSRB elect not to revise its definitions as we recommend above, we strongly recommend that, when proposing any new rules or rule revisions, or publishing any guidance for registrants, the MSRB *expressly* state whether such rule or guidance is intended to apply to both types of products and, to the extent the proposal is intended to apply to both products but would impact them differently, the MSRB notice expressly discuss and explain these differences. We believe this recommendation will go a long way toward addressing the current confusion that arises when trying to determine the intended scope and impact on 529 plan offerings of the MSRB’s rules governing municipal securities.<sup>6</sup>

We respectfully submit that the MSRB’s current notices are additional examples of instances in which municipal securities dealers that are subject to the MSRB’s rules would benefit from the MSRB expressly clarifying that, due to the manner in which municipal fund securities are priced and sold to investors, the MSRB’s proposed fair pricing proposals will not apply to such securities.



The Institute appreciates the opportunity to share our views with the MSRB. Please do not hesitate to contact the undersigned if you have any questions concerning our recommendations or if we can be of any assistance.

Regards,

/s/

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<sup>6</sup> See Letter from the undersigned to Ronald W. Smith, Corporate Secretary, MSRB, dated Feb. 19, 2013, relating to MSRB Notice 2012-63, which sought comment on the MSRB’s existing rules and guidance.

Ronald W. Smith, Corporate Secretary  
September 20, 2013  
Page 4 of 4

Tamara K. Salmon  
Senior Associate Counsel

Cc: Ernesto A. Lanza, Deputy Executive Director, MSRB

**Comment on MSRB NOTICE 2013-16 (August 6, 2013)**

**WHETHER TO REQUIRE DEALERS TO ADOPT A "BEST EXECUTION" STANDARD FOR MUNICIPAL SECURITIES TRANSACTIONS**

Thank you for providing this opportunity to convey thoughts about best execution and transparency. Throughout our response we have directly addressed the questions you have raised while concurrently keeping in mind two important goals: 1) design procedures that ensure the best possible prices for buyers; and 2) be certain that well intended procedures do not ultimately have unexpected consequences that are damaging to investors, particularly in the areas of price and liquidity.

**1) Would implementation of a best execution requirement help ensure investors receive fair and reasonable prices?**

Yes, we believe a best execution requirement would accomplish this; however it is important to take into consideration the type of market, size of order and the liquidity of a particular security. In volatile market environments the value of a particular bond might be significantly different from dealer to dealer. If a dealer is unsure of where a specific credit might trade, the dealer may decline bidding on the item, thereby reducing liquidity and exacerbating wide swings in prices.

**2) Are there certain segments of the municipal market or categories of municipal securities for which a best execution requirement would not be appropriate, e.g. transactions in new issues or transactions in variable rate demand obligations?**

It would be appropriate to apply 'best execution' to new issue trading because there is a defined period of time in which all buyers would receive the original new issue price (post-sale). This would ensure fair pricing. We have responded to the remainder of the questions but believe it would be very difficult to apply the requirement in the secondary market.

**3) Should a best execution requirement apply to all transactions with customers in municipal securities, or should transactions with certain customers, such as sophisticated municipal market professionals (SMMPs) as defined in the interpretation to Rule G-17, on fair dealing, be exempt?**

A best execution requirement should *not* apply to dealer to dealer trades. Inter-dealer trades are executed based on current market conditions, inventory positions, and desk limits. It would be beneficial to show the highest bidder, number of bidders, as well as one or two cover bids. Under the new restated SMMP notice (MSRB notice 2012-27) they would not be exempt as it pertains to both recommended and non-recommended transactions.

**4) Would implementing a best execution requirement support compliance by dealers with their fair-pricing obligations to customers? If so, how would the existing requirements for fair pricing be helped by the application of a best execution requirement?**

It is critical that an industry standard for best execution be developed to give some form of regulatory guidance as to what is considered 'fair and reasonable'. There should be a defined set of guidelines to follow, as well as an outlet, such as an industry contact firms can approach to make inquiries and obtain clarity on what is and isn't permissible in times of market volatility.



**5) Do dealers currently follow a 'best execution' plan in connection with the purchase or sale of municipal securities?**

Yes, we, have adopted a firm policy that would ensure fair pricing for customers. Trade information is offered on EMMA for all investors to see, and our trading desks maintain documentation of bid wanteds and bid wanted history.

**6) Would disclosure that a firm does not utilize a best execution standard be a reasonable alternative to a best execution requirement?**

It would be beneficial to disclose a standard on every trade if we are using 'fair and reasonable' pricing.

**7) Should there be a minimum number of quotations that must be received in order to support the prevailing market price established by a dealer?**

No, this would not be appropriate because some cusips do not trade frequently. Trying to obtain multiple quotes could negatively impact the investor that is in need of liquidity, especially in times of market volatility. It is our experience that in these volatile times a limited number of bids may be available. This does not mean that the bid available is not fair and reasonable, only that it is the only bid available at that time.

The amendment to Rule G-23 implemented on May 27, 2011 that prohibits a broker, dealer, or municipal securities dealer ("dealer") that serves as financial advisor to an issuer for a particular issue sold on either a negotiated or competitive bid basis from switching roles and underwriting the same issue has had the effect of eliminating bids from the market place. We are absolutely convinced that allowing the financial advisor to act in the capacity of underwriter in competitive deals would increase the number of bids and add needed liquidity.

The negative impact of prohibiting financial advisors from bidding on their own competitive issues was strongly illustrated during the market sell off this summer. Liquidity dried up and we saw many instances where only one competitive bid was received for a local issuer. If we, or other financial advisors bringing competitive issues to market, had been allowed to bid, there would have been at least two bids, thereby producing better liquidity and transparency. Issuers were hurt by G-23.

**8) If a best execution standard is adopted, how often should the MSRB require that dealers conduct a review of their practices relating to best execution? What factors would be relevant to a determination whether this review should be more or less frequent?**

NASD Notice to Members 01-22 "Best Execution" states that at a minimum, firms should conduct reviews on a quarterly basis, but should consider whether more frequent reviews are needed depending on various market conditions that may arise. Using this guideline would have all product areas addressed in the same manner.

**9) Should procedures address circumstances under which dealers might seek quotations from:**

- one or more alternative trading systems?**
- one or more broker's brokers?**
- one or more affiliates of the dealer's firm?**
- the dealer firm's clearing firm?**
- dealer firms that participated in the underwriting of the subject municipal securities?**

No, individual dealers should develop procedures on bid wanteds to ensure their customers get the best price. It is not practical to reach out to so many outlets, as some larger firms will not bid items shown on the street.

**10) How could a dealer be expected to ensure best execution when selling a municipal security to an investor from the dealer's inventory?**

Monitoring EMMA is a useful way to ensure best execution if a security is frequently traded. However, it is important to understand that traders can only work with the information that is available at the time of the trade. For less-frequently traded bonds, we perform our own due diligence to determine where the price should be set. This includes credit analysis, locating a comparable bond, as well as taking into consideration the size of the trade.

**11) In the municipal securities market, is it a common practice for customers to direct dealers to solicit bid wanteds from particular dealers, alternative trading systems, or through broker's brokers? If not, should dealers be required to provide these alternatives to customers?**

No, because customers are free to choose whichever dealer they wish to use to obtain a bid. It is not common, but if this is requested by a customer, we will accommodate it, and use our best judgment to determine which platform would be most suitable. Currently, there are three or four platforms that are used throughout the marketplace.

**12) Do customers inquire as to the methods that dealers employ to determine the prevailing market price for municipal securities?**

We do not receive requests directly from customers but occasionally the Financial Consultant may inquire on their behalf.

**13) What are the most significant challenges, if any, currently experienced with interpretation and execution of best execution duties for fixed income securities under FINRA Rule 5310?**

Limited trading makes it difficult to obtain multiple dealer quotes. Fixed-income securities trade with less frequency and less volume than their equity counterparts. If best execution is required, fewer dealers may make a market for a particular fixed-income security. Given our firm's history and its large number of retail trades, we find there can be a disparity between the retail and the round lot trade details. Documenting 'best execution' for odd lots would be a challenge.

**14) Are there alternative methods that the MSRB should consider to provide more transparency to the process dealers employ when determining the prevailing market price for municipal securities in the secondary market that may be more effective for investors and/or less costly or burdensome to dealers? Would a best execution or similar requirement have any negative effect on the protection of investors and the public interest, or on the fair and efficient operation of the municipal market? If so, please describe in detail.**

A consolidated platform should be developed (and possibly published on EMMA) to show all bids and covers received on a specific bond on a specific day. Broker's brokers and alternative platforms should be required to provide this to further improve transparency to all participants.

**15) What tools do dealers employ to document and preserve diligence undertaken to substantiate the basis of the prevailing market price? What other tools might be needed if a best execution or similar requirement were adopted by the MSRB?**

On customer sells, traders review trade price history in EMMA of the issuer's cusip being sold, and make a fair and reasonable bid based upon size, prevailing market conditions, and any current material events that may be relevant to the bond being bid. All this is documented and attached to the trade order ticket. All trade desk offerings reflected on the inventory screens will display any material information that is relevant to the issue being offered, which the FC is to communicate to any customer who may purchase that issue. The FC verifies that these disclosures are made by completing and signing off on a Municipal Bond checklist. A daily internal price variance report is reviewed to determine if any of the current offerings are out of range from the previous 5 day high, low and average price range. A daily executed trade report that

displays the trades from the day before and their price differential from the last trade of the day is also reviewed. Any trades that show a price variance of more than 3 points are researched, and reasons for variance are documented, and if deemed necessary, a price correction will occur.

**16) If your firm conducts a post-trade internal review of pricing, does it audit all trades, a sampling of trades and what frequency is employed for such review, e.g. daily, weekly, month or on a quarterly basis?**

Equity trades are reviewed daily and monthly. This is accomplished by the service of an outside vendor that provides detailed analysis of all trade executions. Fixed Income and Municipals have a sampling of trades reviewed daily to determine if any outlier trades have occurred. This must be done on a manual basis, and at this time, there is no capability to electronically capture all the needed trading data to perform an in-depth analysis. There also is a quarterly manual audit done to review for any possible execution concerns.

**17) If your firm conducts a post-trade internal review, how often does it adjust pricing?**

During the manual daily trade review, if a trade is flagged as an outlier, the appropriate desk is asked for the supporting documentation for the trade in question. If it is then determined that a price adjustment is necessary, the price correction is processed and the appropriate data that was used to justify the correction is added to the record of the trade.

**Alex Rorke  
Director, Public Finance  
J. J. B.Hilliard, W. L. Lyons LLC  
Louisville, KY 40202**

September 26, 2013

Ronald W. Smith, Corporate Secretary  
Municipal Securities Rulemaking Board

Re: MSRB Notice 2013-16

Mr. Smith:

Thank you for the opportunity to comment on the Board's continued quest to apply best-ex to the municipal market. At first blush, this seems like a wonderful idea. However, even the concept of best-ex can be confusing. What is "best execution"? FINRA Rule 5310 defines best execution not as obtaining the best price, but as utilizing due diligence to establish that the client's transaction is executed on the best market to ensure that the client receives the most favorable price under prevailing market conditions. Logic would dictate that the drafters of the rule presumed that the rule would apply where there are multiple markets for a security. This would certainly apply to over the counter and exchange traded equity securities, where the transactions are executed on an almost exclusively agency basis. But is there a reasonable application of this principle to the municipal market?

Although FINRA Rule 5310 attempts to address unquoted markets, it does so in such a fashion as to direct dealers to utilize their expertise to obtain the best execution for clients without defining or providing guidance as to how that is to be accomplished. The Rule does require broker-dealers to establish policies and procedures to ensure that customer orders receive best execution in the absence of a quoted market. Consequently, dealers refer to policies and procedures in demonstrating compliance with FINRA Rule 5310 in the execution of most fixed income transactions.

It should go without mentioning that the municipal market is not a quoted market. The nature of the municipal market- over a million individual securities, many of which are issued in sizes conducive to being held by a single owner- is extremely detrimental to creating a quoted market. Furthermore, unlike equities, municipal securities are not traded on different markets. The municipal market generally consists of dealers buying and selling bonds out of their inventories. Municipal dealers usually will only post bids in response to requests and only offer securities that they own or are fairly certain that they can acquire. The existence of electronic platforms can expedite the process of obtaining responses to bids wanted, but serve the function of a technologically advanced broker's broker. We have all seen the potential negative results of presuming that one's pricing obligations are met by placing a client bid wanted with a third party where the dealer involved does not possess market expertise in a security. A municipal dealer is performing due diligence by making a professional determination as to where the best bid for a certain security may lie. Unlike with equities, it is not the best market, but the dealer with the best understanding of that particular municipal security that will enable a client to obtain the best price. (An argument could be made that the regulators have been on a dedicated march to remove these very market participants from the market, but that is an argument for another day.) In contrast with an agency traded equity security, the broker-dealer whose client asks to

sell a block of municipal securities must use their expertise to determine from whom, not on which market, to obtain the best bid.

Complicating matters is the fact that the bid a municipal dealer may choose to execute might likely be their own. It is understandable that regulators would wish to craft a rule to protect clients in such an instance, particularly when the municipal pricing rule requires that a dealer obtain a price that is fair and reasonable, rather than requiring that a dealer obtain a price indicative of best execution. "Reasonable" just does not appear to the naked eye to be as fair as "best." The fact remains, however, that FINRA's "best" rule applies to determining a market (although granted many refer to it as the "best price" rule), and the Board's rule specifically addresses price. There may be an opportunity to more closely align the municipal rule with FINRA Rule 5310 as it applies to debt securities by adding a due diligence requirement with regard to a sell order that is received from a client. However, any attempt to define the municipal market as several components, all of which are unquoted, would place a burden on municipal market participants that is not applied to participants in any other securities market.

One cannot possess even a basic understanding of the municipal bond market and believe that it is possible to craft a functional best execution rule for instances where securities are offered to clients. With the exception of new issue offerings (where pricing is established by the offering document), rarely do clients ask for a broker to buy a municipal security at market. Generally, a municipal security is offered to a client by a dealer that either owns or controls the municipal security in question. Municipal securities possess very unique descriptive qualities and if a dealer does not own a security, it is extremely unlikely that dealer can locate a party with that security on inventory, buy it and offer that security at a price more favorable to the client than that of the party that owned the security. In other words, the party owning the security is going to have the best offering for that security, because it is the only offering for that security. The issue of the uniqueness of a principally owner-offered market is addressed in the current pricing rules. Additionally, Rule G-13 requires published quotes to be bona fide. No sane individual would make a bona fide offer to sell ninety-nine point nine percent of the municipal securities issues outstanding without having ownership or control of that security. As I have said before, you can find muni sell side best- ex guidance right next to tips on how to ride a unicorn.

Thank you again for the opportunity comment on this issue.

Sincerely,

Chris Melton

# Comment on Notice 2013-16

from Private Investor,

on Monday, September 02, 2013

Comment:

I've had several experiences in past where I've put up a "bid wanted" for some of my bonds through my broker and have had dealers (I assume they are dealers) come back with prices - believe it or not - 8-10 points lower from where the bonds last traded intra-day!

Of course, the bids come in anonymously, so I can't tell who's on the other end, but to me a basic market "price check" by looking at the MSRB historical trade data should be done in order to protect the retail seller from getting ripped off by the bond dealer. There should be some kind of MSRB rule that if a bond has recently traded at, say, 115, that a dealer cannot offer to buy at a price more than n-points from where the last trade was done? For example, maybe that's 3 points away from the last trade, thus dealer cannot buy for lower than 112 in my example.

I've even seen bonds for sale where it's clear the dealer recently bought the bonds from the customer at a very low price, and then turns around to "flip" the position to some uninformed investor for a 5-8 point profit! I've seen many examples like this, and I'm sure if you mined the MSRB trade data you could find plenty of other examples where the prices paid/received by customers were well away from where the dealers delt. Maybe the MSRB has done a study comparing dealer execution prices versus customer execution prices? I'm sure there are plenty of examples of what I speak of hiding in plain sight.

In any case, given the retail nature of muni bond market, I feel that dealers prey upon investors who don't know about using the MSRB trade price history as a guide to what a fair price might be. What can MSRB do to force dealers to conduct an evidenced market "price check" prior to responding to a customer's bid wanted? MSRB needs to do more enforcement here.

Maybe by working more closely with the SEC and adopting something similar to TRACE, MSRB can finally bring some much needed price transparency to the muni bond market.

Sincerely,  
Private Investor



October 7, 2013

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

Re: **MSRB Notice 2013-16(August 6, 2013):  
Request for Comment on Execution Standard**

Dear Mr. Smith:

The Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> appreciates the opportunity to comment on the Municipal Securities Rulemaking Board’s (“MSRB”) Request for Comment on Whether to Require Dealers to Adopt a “Best Execution” Standard for Municipal Securities Transactions<sup>2</sup> (the “Concept Release”). Earlier this year, SIFMA met with certain MSRB and Securities and Exchange Commission staff to present its “Execution with Diligence” proposal to improve the execution standard in the municipal market (the “SIFMA Proposal” or “Proposal”).<sup>3</sup> SIFMA’s Proposal, suggesting revisions to MSRB Rule G-18, is attached hereto, and incorporated herein, as a part of SIFMA’s response to MSRB Notice 2013-16. SIFMA feels strongly that raising execution standard provides an opportunity to improve public trust and confidence in the municipal securities market. More important than a rule’s label, is the process that dealers would have to undertake.

SIFMA agrees with the MSRB that “execution” targets the process by which firms handle orders and is complimentary to existing MSRB rules and interpretive guidance

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<sup>1</sup> 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).

<sup>2</sup> MSRB Notice 2013-16 (August 6, 2013) available at <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-16.aspx?n=1>

<sup>3</sup> 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.

governing fair pricing obligations. This standard appropriately balances investor-protection interests with the need for efficient municipal markets. SIFMA is also in agreement with the MSRB that copying the existing standards from the equity and corporate fixed income markets may not be the optimal manner to promote fair pricing in the municipal market. We concur with the MSRB that any new execution requirements should be uniquely tailored to the municipal securities market. Any divergence from existing equity and corporate debt securities execution requirements should not be intended to dilute them, but to impose requirements that are properly tailored for the municipal market. SIFMA's Proposal moves the industry forward in a robust way that further enhances standards so that customers receive fair and reasonable prices. While the market may evolve to a central trading platform over the next several years, SIFMA's Proposal advances the industry towards a higher execution standard, in a way that is achievable, in the near term.

## **I. Market Structure**

There are significant municipal market structure barriers to “best execution” – as it is commonly perceived to operate by investors. Many investors are familiar, at least at a high level, with equities market structure – they are traded on exchanges with constant liquidity and a view into the entire market. Since municipal bonds are not traded on a central exchange and there is no central aggregator of bid/offers, execution in the municipal market cannot be mirrored on either an equities or corporate debt “best execution” standard. As detailed in the charts below, the municipal securities market has fundamental differences from other markets, including other fixed income markets<sup>4</sup>. These differences include its diverse and fragmented nature, small securities trade sizes and far less liquidity than corporate bonds. SIFMA supports efforts to improve trade execution standards while noting that the inherent unique characteristics of the municipal market do not lead to a simple one size fits all solution. Accordingly, SIFMA's Proposal is structurally similar to FINRA 5310<sup>5</sup> but modified to reflect the unique characteristics of the municipal securities market.

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<sup>4</sup> See *Corporate Bond E-Trading: Same Game, New Playing Field* by McKinsey & Company and Greenwich Associates (August 2013).

<sup>5</sup> In absence of written guidance from FINRA regarding the application of FINRA 5310 to other fixed income securities markets, municipal securities dealers are concerned how such a rule could be enforced in the municipal market in light of these significant market differences.



## MARKET STRUCTURE COMPARISON

	EQUITIES MARKET	CORPORATE DEBT SECURITIES MARKET	MUNICIPAL SECURITIES MARKET
<b>Multiple Trading Centers: E.g. Exchanges, ATSS</b>	Yes	No (Non-NMS OTC Market)	No (Non-NMS OTC market)
<b>Access to Quotations: Anti-discrimination rules that provide exchanges can't put forth unfairly discriminatory terms that prevent access to their displayed quotations (Reg. NMS Rule 610)</b>	Yes	No	No
<b>Order Protection Rule: Requires that trading centers match best quoted prices or route orders to the best price (Reg. NMS Rule 611)</b>	Yes	No	No
<b>Pre and Post Trade Transparency: Direct Data Feeds &amp; Security Information Processors (Public Distribution of Bids/Offers, NBBO, Last Sales)</b>	Yes	No (Disseminated TRACE transaction data includes price, time of execution, size and other information. The size disseminated is the total par value of the trade, subject to the limits of the applicable dissemination cap. For investment grade TRACE-eligible securities and agency debt securities, the current dissemination cap is \$5 million, and a transaction in excess of \$5 million is disseminated as "\$5MM+." For non-investment grade TRACE-eligible securities, the current dissemination cap is \$1 million, and a transaction in excess of \$1 million is disseminated as "\$1MM+.")	No (Disseminated EMMA transaction data includes price, time of execution, size, yield, interest rate and other information. The size disseminated is the total par value of the trade. Trades with a par value greater than \$5 million are disseminated with an indicator of "MM+." The exact par value of transactions where the par value is greater than \$5 million are disseminated on EMMA five business days later.)
<b>Daily Liquidity</b>	Regular and continuous market: Multiple bids and offers on each CUSIP daily. Average US stock traded around 3,800 times per day in 2012. <sup>1</sup>	Limited Liquidity: 38% of TRACE-eligible securities did not trade even once, with another 23% trading only a handful of times, as compared to 1% that traded every day. <sup>1</sup>  The 13 most liquid US investment grade and 20 most liquid high yield corporate bond issues traded only about 85 times and 65 times per day on average. <sup>1</sup>	Limited Liquidity: Municipal bonds are even less liquid than corporate bonds. For example, in 2011, 99% of municipal bonds did not trade on any given day. <sup>2</sup>

1. Corporate Bond E-Trading: Same Game, New Playing Field by Mckinsey & Company and Greenwich Associates (August 2013)  
2. U.S. Securities and Exchange Commission, Report on the Municipal Securities Market (July 2012)

## MARKET COMPARISON

	EQUITIES MARKET	CORPORATE DEBT SECURITIES MARKET	MUNICIPAL SECURITIES MARKET
<b># CUSIPS</b>	N/A	55,000 <sup>1</sup>	1,100,000 <sup>1</sup>
<b># Issuers</b>	6,775 <sup>2</sup>	5,500 <sup>3</sup>	55,000 <sup>1</sup>
<b>\$\$ Outstanding (\$ bln)</b>	\$22,211 <sup>2</sup>	\$8,325 <sup>4</sup>	\$3,719 <sup>4</sup>
<b>Trading volume (unique) CUSIP (Average daily)</b>	5,766 <sup>2</sup>	28,097 <sup>5</sup>	15,217 <sup>6</sup>
<b>Par Amount (\$ mln, average daily)</b>	\$110,560.00 <sup>2</sup>	\$13,011.00 <sup>5</sup>	\$13,038.80 <sup>6</sup>
<b>Number of Trades (Average daily - NYSE Only)</b>	17,926,919 <sup>2</sup>	41,307 <sup>5</sup>	41,257 <sup>6</sup>
<b># of CUSIPS that don't trade on a given day</b>		-26,903	-1,084,783
<b>Retail customers (Direct holdings, \$ bln)</b>	8,140.2 <sup>4</sup>	N/A	1,657.7 <sup>4</sup>
<b>Institutional customers (Direct holdings, \$ bln)</b>	14,071.2 <sup>4</sup>	N/A	2,061.7 <sup>4</sup>

1. Bloomberg
2. NYSE, NASDAQ, AMEX
3. Thompson Reuters
4. Federal Reserve
5. FINRA
6. MSRB

## II. Focus on the Process

SIFMA's Proposal is principles based. Additionally, it does not favor one execution venue over another. Similar to FINRA 5310, dealers would be required to "use reasonable diligence to ascertain the market for the subject security so that the resultant price to the customer is fair and reasonable<sup>6</sup> under prevailing market conditions." We believe it is more productive to focus on the actual process that dealers would have to undertake rather than the label, as "best execution" is a term of art and will have a different meaning in each market as each market functions differently. The SIFMA Proposal contains a non-exhaustive list of factors that may be considered in determining whether a dealer has used

<sup>6</sup> "Fair and reasonable" is the current MSRB pricing standard. See MSRB Notice 2013-15 (August 6, 2013), available at <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-15.aspx?n=1>.

reasonable diligence. SIFMA encourages the MSRB to include statements in subsequent regulatory notices that a dealer's obligation is inherently one to observe a reasonable / quality process -- a process that may or may not ultimately lead to an execution price that is incrementally away from some other reported trade on the day. Certainly other reported trades are relevant -- for surveillance, for compliance, for supervisors, for customers -- but the rule and guidance ought not to lead regulatory staff to form an inflexible view that the low price on the day, without more, is necessarily the product of deficient execution assuming a sound process is in place.

### **III. One Execution Standard for All Customers**

MSRB rules exempt dealers from certain obligations when dealing with sophisticated municipal market participants ("SMMPs"). Accordingly we believe this would be the logical dividing line consistent with the current MSRB rule structure for a different execution standard for retail versus institutional customers. However, SIFMA believes there should be one execution standard for all customers for the following reasons:

- Many institutional customers have a view of the depth of market and can direct trades to a particular counterparty (See SIFMA Proposal (a)(1)(E));
- Absence of a rationale for a different standard for institutional investors;
- Distraction from main goal of improving the execution standard; and
- FINRA 5310 does not differentiate between retail and institutional customers.

### **IV. Use of ATs and Broker's Brokers**

SIFMA's Proposal supports the consideration of the full range of counterparties and does not favor one execution counterparty over another. SIFMA's Proposal defines "market" or "markets" as encompassing "those brokers, dealers, and municipal securities dealers that are known to transact in a particular security. This interpretation is meant to both inform brokers, dealers, and municipal securities dealers as to the breadth of the scope of counterparties that may be considered in the furtherance of their execution obligations and to promote fair competition among brokers, dealers, municipal securities dealers, such as dealers acting as municipal securities "broker's brokers" as defined in Rule G-43, alternative trading systems or platforms, as well as any other counterparties that may emerge, by not mandating that any trading counterparties have more or less relevance than others in the course of determining a firm's execution obligations."

Any rule that would require dealers to seek quotations from one or more alternative trading systems ("ATS") or municipal securities broker's brokers ("MSBB") would be problematic, and in some cases hinder liquidity:

- Despite G-43's prohibitions, ATs and MSBBs are often used for price discovery rather than trade execution, so some prices may not reflect market participant's views of true market value;

- Since there is no central trading platform, duplicate offerings for the some bonds often occur, falsely indicating more activity/interest than exists;
- Many bids are not credible;
- May have a chilling effect on market, limiting bids;
- Many bid-wanted do not result in any bids;
- Results from a bid-wanted is one piece of information in deciding whether to execute that sale at that price;
- Since most bid-wanted do not result in any trades, this may reduce incentives to bid aggressively;
- Because the winning bid in a bid-wanted auction may not reflect a fair price, it would be inappropriate for dealers to depend solely on this process;
- A dealer buying or selling from its own inventory is often able to get its customer a fair and reasonable price without using an ATS or MSBB; and
- FINRA 5310 does not have such a requirement, nor does FINRA 5310 require a minimum number of quotations that must be received.

An enhanced MSRB execution rule should be prescriptive as to results instead of prescriptive as to process. Accordingly, SIFMA opposes any rule that would require dealers to seek quotations from one or more ATS or MSBB or mandate a minimum number of quotations that must be received. Each dealer must decide on its own the manner in which it will obtain fair and reasonable prices for its customers.

## **V. Supervisory Post Trade Review of Execution Quality**

The Supplementary Material in FINRA 5310 requires firms to conduct reviews of its execution quality. Similarly, SIFMA's Proposal would require dealers, as part of its system of supervision, to conduct periodic reviews of the fairness of customer execution prices. Firms would also be required to analyze whether the frequency of their reviews are sufficient. To assure that a dealer complies with its obligation to provide fair and reasonable pricing for customer transactions, it should compare, among other things, execution prices that they are obtaining via current execution practices (including the internalization of customer transactions) to the execution prices that the dealer could obtain from alternative practices. SIFMA's Proposal contains a non-exhaustive list of factors that may be considered. This aspect of the SIFMA Proposal would be a new regulatory requirement, as many dealers currently conduct post-trade reviews of execution prices. It, however, would require them to, as described above, consider alternative execution practices, if for example better prices could be obtained from other trading counterparties.

## **VI. Economic Analysis**

SIFMA and its members believe that evaluating the costs and burdens of new regulation, and weighing those costs against any benefits derived from such new regulation, is critical to ensure efficient regulation. An essential component of this

principle is conducting a true, reality-based, (and if possible dollar-specific) cost-benefit analysis of new rule proposals and other initiatives. Fully consider the costs and burdens to both the MSRB and its funders weighed against potential benefits, which we understand are much more difficult to value. SIFMA is pleased that the MSRB has adopted a formal framework for its approach to integrate economic analysis into its proposed rulemaking.<sup>7</sup>

Prior to proceeding to rule making on whether to require dealers to adopt a “best execution” standard, SIFMA urges the MSRB to conduct a cost benefit analysis of all of the components of any future MSRB proposal. There is a concern that imposing an equities-like “best execution” standard on the municipal market would impose undue costs and burdens on dealers (without necessarily resulting in better outcomes) which may result in some discontinuing offering municipal securities to their retail customers negatively impacting liquidity in this market. It is critical that the MSRB strike the appropriate balance between investor protection interests and the efficient operation of the municipal markets.

## **VII. Conclusion**

SIFMA sincerely appreciates this opportunity to comment upon the Concept Release. SIFMA supports raising the execution standard in the municipal market in a way that reflects the current market structure and unique characteristics of the municipal market. We believe SIFMA’s Proposal meets this criteria.

SIFMA looks forward to continuing its dialog with the MSRB on this important topic.

Please do not hesitate to contact me with any questions at (212) 313-1265.

Sincerely yours,



David L. Cohen  
Managing Director  
Associate General Counsel

Attachments: Letter to Lynnette Kelly, dated June 24, 2013  
Proposed Amendments to MSRB Rule G-18: Execution of Transactions

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<sup>7</sup> Policy on the Use of Economic Analysis in MSRB Rulemaking (September 26, 2013) available at <http://msrb.org/About-MSRB/Financial-and-Other-Information/Financial-Policies/Economic-Analysis-Policy.aspx>

Mr. Ronald W. Smith  
Municipal Securities Rulemaking Board  
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cc:

***Municipal Securities Rulemaking Board***  
Lynnette Kelly, Executive Director  
Gary L. Goldsholle, General Counsel  
Kathleen Miles, Associate General Counsel



June 24, 2013

Lynnette Kelly  
Executive Director  
Municipal Securities Rulemaking Board  
1900 Duke Street  
Alexandria, VA 22314

Re: SIFMA Recommendation to Improve Customer Execution

Dear Ms Kelly,

As you know, the U.S. Securities and Exchange Commission issued a Report on the Municipal Securities Market in July 2012<sup>1</sup> (the "SEC Report" or "Report"). Since the Report's release, the Municipal Securities Division of the Securities and Financial Markets Association ("SIFMA")<sup>2</sup> has been 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 take particular notice of issues raised in the Report that suggesting 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 Municipal Securities Rulemaking Board ("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."

<sup>1</sup> 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>.

<sup>2</sup> 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).

New York | Washington

120 Broadway, 35th Floor | New York, NY 10271-0080 | P: 212.313.1200 | F: 212.313.1301  
www.sifma.org

- The municipal market is much more diverse and fragmented: over 1.1 million unique CUSIPs issued by over 55,000 state and local government entities.
- Average issue sizes (on average \$27mm),
- Small unique securities trade sizes (> \$50,000) dominate daily trading activity.
- The municipal market is also dominated by odd-lot transactions in thinly traded issues.
- Municipal bonds are less liquid than corporate bonds. For example in 2011, about 99% of outstanding municipal bonds did not trade on any given day.
- Trades involving retail investors necessarily take place directly into or out of dealer inventories or through platforms or voice brokers that facilitate bid-wanted auctions.
- On any given day, a dealer that is active in the market may have between 2,000 to 5,000 items to potentially bid upon, and therefore review, and may eventually bid upon hundreds of these items. That same dealer could also have a number of items out for bid, for which it will need to devote additional attention.
- Role of brokers broker/voice brokers: Municipal securities brokers provide liquidity to the secondary bond market, extend distribution networks, information flow, and anonymity to market participants. Many have a particular local, regional, or market sector expertise.
- Many bid-wanted do not result in any bids; results from a bid wanted is one piece of information in deciding whether to execute that sale at that price. The fact that most bid-wanted processes do not result in trades may reduce incentives

The municipal securities market has fundamental differences from other markets, including other fixed income markets, yet SIFMA understands the regulators' desire to move the municipal market *towards* a corporate debt execution standard. Some of these fundamental differences include:

## I. Background of Current Municipal Market Structure

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 months with the goal of producing a recommended policy change, attached hereto, designed to strengthen trade execution in the municipal market. The following discussion is the product of that effort.



for dealers to bid aggressively. A dealer may be buying or selling from its own inventory, seeking bids from other dealers or using the services of MSBBS or ATS. Some bid-wanted don't trade because the seller doesn't like the prices bid, or was just using the process for price discovery.

## II. Proposal Summary

### Rule Proposal:

SIFMA proposes that MSRB Rule G-18 be amended to reflect an "execution-with-diligence" standard for transactions with customers. Dealers would be required to "use reasonable diligence to ascertain market so that the resultant price to the customer is fair and reasonable under prevailing market conditions." Similar to FINRA 5310, SIFMA's proposal contains a non-exhaustive list of factors that may be considered in determining whether a dealer has used reasonable diligence.

### Proposal for Supplementary Material:

Recognizing that municipal securities trade in an over the counter market without a central exchange, SIFMA proposes defining the term "market" or "markets" to encompass those brokers, dealers, and municipal securities dealers that are known to transact in a particular security. Additionally, municipal securities dealers would be required to conduct a post trade review of execution quality and compare, among other things, execution prices that they are obtaining via current execution practices to the execution prices they could obtain from alternative trading counterparties.

## III. Process

Due to the magnitude of this change, we recommend vetting this proposal among market participants through the use of a concept proposal, with an expanded comment period, and opportunity for feedback at round table discussions and educational events. Regulated firms would need an implementation period of at least six to nine months to be able to code for the necessary systems changes, develop policies and procedures and requisite changes in behavior.

## IV. Conclusion

Some points emphasized in the Report suggest the transformation of the secondary municipal market to a central trading platform. However, the market is not yet at that stage of evolution. SIFMA's proposal moves the industry forward in the short-term, in a realistic and obtainable way. The MSRB should consider the short-term and long-term costs and potential benefit of any rule making before formally proposing any changes.

Ms. Lynette Kelly  
Municipal Securities Rulemaking Board  
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We look forward to a continuing dialog with the MSRB on this important issue.  
Please do not hesitate to call me with any questions at 212-313-1265.

Sincerely,



David L. Cohen  
Managing Director and  
Associate General Counsel

**Rule G-18: [Municipal Market] Execution**

(a)(1) In any transaction for or with a customer, a broker, dealer, or municipal securities dealer shall use reasonable diligence to ascertain the market for the subject security so that the resultant price to the customer is fair and reasonable under prevailing market conditions. Factors that may be considered in determining whether a broker, dealer, or municipal securities dealer has used "reasonable diligence" include, but are not limited to:

(A) the character of the market for the security (e.g., demand, availability, price, volatility, relative liquidity, including size of the issue and issuer);

(B) the size and type of transaction;

(C) information reviewed to ascertain the current market for the subject security or similar securities;

(D) accessibility of any quotations<sup>1</sup> and the likelihood of execution at that price;

(E) the terms and conditions of the customer's inquiry including bids and offers, if any, which result in the transaction, as communicated to the broker, dealer, or municipal securities dealer;

(F) the capacity, principal or agent, of the broker, dealer, or municipal securities dealer affecting the transaction; and

(2) In any transaction for or with a customer, no broker, dealer, or municipal securities dealer shall interject a third party between the broker, dealer, or municipal securities dealer and the buyer or seller for the subject security in a manner inconsistent with paragraph (a)(1) of this Rule.

(b) Failure to maintain adequate resources such as staff, technology, and market and indicative information necessary to perform reasonable market diligence cannot be considered justification for executing away from a fair and reasonable price.

(c) The obligations described in paragraphs (a) and (b) above exist regardless if the broker, dealer, or municipal securities dealer is acting as agent or principal. Such obligations should be considered in conjunction with MSRB Rule G-30.

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<sup>1</sup> MSRB Rule G-13 defines "quotation" as "any bids for, or offers of municipal securities, or any request for bids for or offers of municipal securities, including indications of 'bid wanted' or 'offer wanted'."

• • • Supplementary Material: -----

**.01 Execution of Customer Transactions.** A broker, dealer, or municipal securities-dealer must make every effort to execute a customer transaction promptly in accordance with the terms of the customer's bid or offer and other instructions.

**.02 Definition of "Market."** Recognizing that municipal securities trade in an over the counter market without a central exchange, for the purposes of Rule G-18 and the accompanying Supplementary Material, the term "market" or "markets" encompasses those brokers, dealers, and municipal securities dealers that are known to transact in a particular security. This interpretation is meant to both inform brokers, dealers, and municipal securities dealers as to the breadth of the scope of counterparties that may be considered in the furtherance of their execution obligations and to promote fair competition among brokers, dealers, municipal securities dealers, such as dealers acting as municipal securities "broker's brokers" as defined in Rule G-43, alternative trading systems or platforms, as well as any other counterparties that may emerge, by not mandating that any trading counterparties have more or less relevance than others in the course of determining a firm's execution obligations.

**.03 Execution and Municipal Securities.** Rule G-18(a)(1)(D) provides that one of the factors used to determine if a broker, dealer, or municipal securities dealer has used reasonable diligence to ascertain the market for the subject security so that the resultant price to the customer is fair and reasonable is the "accessibility of the quotation." In the context of the municipal securities market, this means that, when "quotations", as defined in MSRB Rule G-13, are available, the appropriate regulatory agencies will consider the accessibility and the likelihood of execution of such quotations when examining whether a broker, dealer, or municipal securities dealer has used reasonable diligence. Accessibility is only one of the non-exhaustive reasonable diligence factors set out in Rule G-18(a)(1). In the absence of accessibility, brokers, dealers, or municipal securities dealers are not relieved from taking reasonable steps and employing their market expertise in conducting reasonable diligence.

**.04 Execution and Executing Brokers.** A broker, dealer, or municipal securities dealer's duty to use reasonable diligence to ascertain the market for the subject security so that the resultant price to the customer is fair and reasonable in any transaction is, unless otherwise specified in this rule and supplemental materials to this rule, limited to their own customers and not to customers of other brokers, dealers, or municipal securities dealers. A broker, dealer, or municipal securities dealer's duty to use reasonable diligence to ascertain the market for the subject security so that the resultant price to the customer is fair and reasonable in any transaction arises only when a bid or offer is directed to them for the purpose of transaction handling and execution. It does not apply in instances when the broker, dealer, or municipal securities dealer's services with respect to the transaction have been anonymous and explicitly limited to communication, order matching, and/or clearance functions. Additionally, the duties of a dealer acting as a "broker's broker" are defined in MSRB Rule G-43.

**.05 Bids and Offers Involving Securities with Limited Quotations or Pricing Information.** Although the market diligence requirements in Rule G-18 apply to bids and offers for all municipal securities, markets for securities may differ dramatically. One of the areas in which a broker, dealer, or municipal securities

dealer must be diligent in ensuring that it has met its market diligence obligations is with respect to customer bids and offers involving securities for which there is limited pricing information or quotations available. Diligence in these circumstances shall include a procedure to learn information as necessary to meet the reasonableness standard, even though the means of information gathering may be different than that for other municipal securities. Each broker, dealer, or municipal securities dealer must have written policies and procedures in place that address how they will ascertain the market for such a security in the absence of relevant pricing information or multiple bids or offers and must document its compliance with those policies and procedures.

**.06 Customer Instructions Regarding Handling of Bid or Offer.** If a broker, dealer, or municipal securities dealer receives an unsolicited instruction from a customer to execute a transaction in a particular manner, the broker, dealer, or municipal securities dealer is not required to make any execution handling determination beyond the customer's specific instruction. Brokers, dealers, or municipal securities dealers are, however, still required to act promptly with respect to that customer's bid or offer promptly and in accordance with the terms of the bid or offer, or any instructions of the customer.

#### **.07 Review of Execution Quality.**

(a) No broker, dealer, or municipal securities dealer can transfer to another person its obligation to make use reasonable diligence to provide fair pricing for its customers' bid or offer. As part of its system of supervision, a broker, dealer, or municipal securities dealer must have procedures in place to ensure the broker, dealer, or municipal securities dealer periodically conducts reviews of the fairness of the customers' execution prices. Firms should also periodically analyze whether the frequency of their reviews are sufficient.

(b) To assure that a broker, dealer, or municipal securities dealer complies with its obligation to provide fair and reasonable pricing for customer transactions, it should compare, among other things, execution prices that the broker, dealer, or municipal securities dealer is obtaining via current execution practices (including the internalization of customer transactions) to the execution prices that the broker, dealer, or municipal securities dealer could obtain from alternative practices. In reviewing and comparing the execution quality of its current execution practices to the execution quality with other counterparties, a broker, dealer, or municipal securities dealer may consider the following factors:

(1) price improvement opportunities (i.e., the ability to obtain better prices from alternate counterparties);

(2) the likelihood of execution of limit orders;

(3) the speed of execution;

(4) the size of execution;

(5) transaction costs; and

(6) customer needs and expectations.  
(c) A broker, dealer, or municipal securities dealer that directs its customer transactions to another broker, dealer, or municipal securities dealer that has agreed to handle those transactions as agent, or riskless principal for the customer (e.g., a clearing firm or other executing broker-dealer) may rely on that broker, dealer, or municipal securities dealer's periodic review as long as the results and rationale of the review are fully disclosed to the broker, dealer, or municipal securities dealer and the broker, dealer, or municipal securities dealer periodically reviews how the review is conducted, as well as the results of the review.



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Member FINRA/SIPC

October 7, 2013

**Via E-mail to <http://www.msrb.org/CommentForm.aspx>**

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

**RE: MSRB Notice 2013-16 Request for Comment on Whether to Require Dealers to Adopt a “Best Execution” Standard for Municipal Securities Transactions**

Dear Mr. Smith:

Wells Fargo Advisors, LLC (“WFA”) appreciates the opportunity to comment on the Municipal Securities Rulemaking Board’s (“MSRB” or “the Board”) concept release regarding adoption of a best execution standard similar to that applied to corporate bonds and equities pursuant to Financial Industry Regulatory Authority (“FINRA”) Rule 5310. WFA commends the Board’s approach in contemplating a potential best execution standard and for its recognition that simply “copying the existing standards” currently applied to the corporate bond and equity markets “may not be the optimal manner to promote fair pricing in the municipal market.”<sup>1</sup>

WFA consists of brokerage operations that administer almost \$1.4 trillion in client assets. It employs approximately 15,268 full-service financial advisors in branch offices in all 50 states and 3,340 licensed financial specialists in 6,610 retail bank branches in 39 states.<sup>2</sup> WFA offers

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<sup>1</sup> MSRB Notice 2013-16 Request for Comment on Whether to Require Dealers to Adopt a “Best Execution” Standard for Municipal Securities Transactions, (August 6, 2013), <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-16.aspx?n=1>.

<sup>2</sup> WFA is a non-bank affiliate of Wells Fargo & Company (“Wells Fargo”), a diversified financial services company providing banking, insurance, investments, mortgage, and consumer and commercial finance across the United States of America and internationally. Wells Fargo has 275,000 team members across more than 80 businesses. Wells Fargo’s brokerage affiliates also include Wells Fargo Advisors Financial Network, LLC (“WFAFN”) and First Clearing, LLC, which provides clearing services to 88 correspondent clients, WFA and WFAFN. For the ease of discussion, this letter will use WFA to refer to all of those brokerage operations.

a range of fixed income solutions to its clients, many of whom regularly transact in municipal securities in the secondary markets.

WFA offers the comments herein to express its continued support of the existing fair-pricing standard and to discuss its concerns about the remaining structural impediments to the application of a FINRA-like best execution standard in the municipal market.

## **I. Structural Differences Between Municipal Markets and those Covered by FINRA's Best Execution Rule Support Continuation of a Municipal Fair-Pricing Standard.**

As noted above, the Board acknowledges the differences between equity and fixed income markets covered by FINRA's Best Execution Rule, and municipal bond markets. Given the distinctions, the MSRB recognizes "any 'best execution' requirement should be uniquely tailored to the attributes of the municipal securities market." WFA believes, however, the MSRB's existing fair-pricing standard strikes the appropriate balance between investor protection and efficiently functioning municipal markets.<sup>3</sup>

In light of current market conditions, a shift to a best execution standard similar to that outlined in FINRA Rule 5310 may negatively impact the fair and efficient operation of the municipal bond market. A more prescriptive best execution rule could slow down the execution process in many municipal securities. The "best execution" requirements may cause dealers to delay execution of a municipal security at a fair market value to fulfill the FINRA rule's multi-factor "reasonable diligence" analysis. In particular, satisfying such criteria as "the number of markets checked" may be impractical where such information is unavailable. Moreover, even if available, some such data may not reflect actual market value or may not be readily accessible given the fragmented market structure and nature of the securities traded.<sup>4</sup>

The municipal market comprises fewer dealers and venues in comparison to the markets covered by the FINRA Best Execution Rule, with the top 10 dealers representing approximately 75% of the par amount of customer transactions in the secondary municipal market.<sup>5</sup> Furthermore, the frequency with which municipal dealers transact in municipal securities for which no quote is currently accessible is much higher than in the markets covered by the FINRA Best Execution Rule. As the SEC notes in its 2012 Report on the Municipal Securities Market, only 1% of the more than one million municipal securities outstanding trade on any given day.<sup>6</sup> In contrast, a brief review of 2011 corporate bond transaction data available on FINRA's TRACE Market Data site illustrates it was common for as much as 10% of the approximately 50,000

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<sup>3</sup> Wells Fargo Advisors, LLC, Letter from Robert J. McCarthy, Director of Regulatory Policy, dated September 20, 2013. (Commenting on Proposed Fair-Pricing Rule Contained in MSRB Notice 2013-15)

<sup>4</sup> See proposed Supplementary Material .04 accompanying proposed consolidated Fair-Pricing Rule, MSRB 2013-15 Request for Comment on Fair-Pricing Rule, (August 6, 2013), <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-15.aspx?n=1>.

<sup>5</sup> SEC Report on the Municipal Securities Market, 20, July 31, 2012. <http://www.sec.gov/news/studies/2012/munireport073112.pdf>.

<sup>6</sup> *Id.* at 5, 113.



corporate bonds outstanding to trade on a given day.<sup>7</sup> The differences between equity markets and the municipal markets are even more pronounced, with equities trading in linked markets from which dealers can generally find immediate access to the national best bid or offer (“NBBO”) when handling customer orders.

It is worth noting supplementary material to FINRA Rule 5310 recognizes that a quote may be less likely to be accessible for corporate bonds than equities but requires dealers to employ “reasonable steps” and apply “market expertise” to meet its best execution obligations.<sup>8</sup> Similarly, under the current MSRB standard, diligence must be exercised in establishing market value of a municipal bond, guided primarily by “prevailing market price” when available, but permitting consideration of the dealer’s “best judgment” concerning “fair market value.”<sup>9</sup> Although both standards vest judgment with the dealer, WFA believes the existing fair-pricing standard better reflects the conditions and structure of the municipal market, where quotes are routinely unavailable or inaccessible. Furthermore, even when quotes are available, they may not be reflective of a municipal bond’s actual market value. If a dealer in such a market is required to fulfill predicate diligence steps, as required under Rule 5310(a), the efficient operation of the municipal markets could be undermined.

## **II. FINRA’s Requirement of Regular and Rigorous Reviews is Not Suited to Municipal Market Conditions.**

FINRA 5310 Supplementary Material .09 outlines a dealer’s obligations to conduct “regular and rigorous reviews” to assess the quality of customer executions whether it routes its customers’ orders or internalizes its customer orders. If the dealer determines there “are material differences among the markets trading the security,” the dealer must either modify its procedure or justify why modification is not appropriate. The Rule prescribes the factors dealers “should consider” in its evaluation of its routing or internalization practices.

As described above, there are fundamental structural differences in the character of the municipal market and the markets for securities currently subject to FINRA’s Best Execution Rule. For example, market centers handling equity orders are required to publish detailed monthly reports under SEC Rule 605 regarding the execution quality provided to certain customer orders.<sup>10</sup> Key report metrics are focused on execution prices relative to the prevailing consolidated quote at the time of order execution and are sufficiently standardized to facilitate an “apples-to-apples”-type comparison across various market centers competing for customer order flow. Equivalent, standardized execution quality metrics do not exist in the municipal market, which would inhibit a firm’s ability to perform a meaningful “regular and rigorous” review of executions.

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<sup>7</sup> FINRA TRACE Market Data. <http://finra-markets.morningstar.com/BondCenter/TRACEMarketAggregateStats.jsp>

<sup>8</sup> FINRA Rule 5310, Supplementary Material .03, Best Execution and Debt Securities.

<sup>9</sup> MSRB Review of Dealer Pricing Responsibility, January 26, 2004. *See also* MSRB Notice 2013-15, Request for Comment on Proposed Fair-Pricing Rule.

<sup>10</sup> Disclosure of SEC-Required Order Execution Information (Rule 605), <http://apps.finra.org/datadirectory/1/marketmaker.aspx>

Ronald W. Smith

October 7, 2013

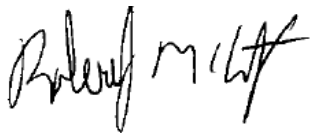
Page 4 of 4

Instead of imposing a “regular and rigorous” review requirement comparable to that under FINRA’s Best Execution Rule, WFA believes the MSRB should preserve existing supervisory obligations, which effectively require firms to maintain reasonably designed supervisory policies and procedures to ensure prices are fair and reasonable. Such policies and procedures should ensure appropriate due diligence is exercised to establish a security’s market value by maintaining processes to validate pricing on customer trades using available sources (*e.g.*, the MSRB’s Electronic Municipal Market Access database or “EMMA”). WFA believes the MSRB’s current standard preserves the flexibility needed to conduct a review appropriate for the state of the municipal markets.

## CONCLUSION

WFA appreciates the opportunity to share its views about a potential best execution standard and commends the MSRB for its acknowledgment that any such rule should advance existing fair-pricing obligations and account for differences inherent in the market for municipal securities. As described in the foregoing comments, WFA believes the fair-pricing duty remains appropriate in the context of current municipal market conditions.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert J. McCarthy". The signature is stylized and cursive.

Robert J. McCarthy  
Director of Regulatory Policy

2014-02

**Publication Date**

February 19, 2014

**Stakeholders**

Municipal Securities  
Dealers, Investors,  
General Public

**Notice Type**

Request for  
Comment

**Comment Deadline**

March 21, 2014

**Category**

Fair Practice, Market  
Transparency

**Affected Rules**

[Rule G-18](#)

## Request for Comment on Draft Best-Execution Rule, Including Exception for Transactions with Sophisticated Municipal Market Professionals

### Overview

The Municipal Securities Rulemaking Board (MSRB) is seeking comment on draft MSRB Rule G-18 on best execution of transactions in municipal securities. The draft rule requires brokers, dealers and municipal securities dealers (dealers) to use reasonable diligence in seeking to obtain for their customer transactions in municipal securities the most favorable terms available under prevailing market conditions. The MSRB is also seeking comment on draft amendments to proposed MSRB Rule G-48, on transactions with sophisticated municipal market professionals (SMMPs), to exempt transactions with SMMPs from the application of draft Rule G-18. In addition, the MSRB is seeking comment on the likely economic consequences of the adoption of these changes.

Comments should be submitted no later than March 21, 2014, and may be submitted in electronic or paper form. [Comments may be submitted electronically by clicking here.](#) Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314. All comments will be available for public inspection on the MSRB's website.<sup>1</sup>

Questions about this notice should be directed to Michael L. Post, Deputy General Counsel, or Kathleen Miles, Associate General Counsel, at 703-797-6600.

<sup>1</sup> Comments are posted on the MSRB website without change. Personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.

## Background

As the principal regulator of the municipal securities market, the MSRB is charged by Congress to protect investors and foster a “free and open” municipal securities market.<sup>2</sup> The MSRB, consistent with that charge, has advanced many initiatives to improve transparency, efficiency and other structural aspects of the market.<sup>3</sup> In alignment with these efforts, the MSRB believes that the establishment of a requirement that dealers seek best execution of customer transactions in municipal securities will have benefits for investors, promote competition among dealers and improve market efficiency.

As generally understood, best-execution obligations and fair-pricing obligations are closely related but distinct. MSRB Rule G-18 (Execution of Transactions)<sup>4</sup> and Rule G-30 (Prices and Commissions)<sup>5</sup> generally require

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<sup>2</sup> Securities and Exchange Act of 1934 § 15B(b)(2)(C), 15 U.S.C. 78o-4(b)(2)(C).

<sup>3</sup> See MSRB Long-Range Plan for Market Transparency Products (Jan. 27, 2012), available at <http://www.msrb.org/msrb1/pdfs/Long-Range-Plan.pdf>. The MSRB has requested comment and is analyzing information from market participants on potential improvements to the timeliness, fairness and efficiency of price transparency in the municipal market. See Concept Release on Pre-Trade and Post-Trade Pricing Data Dissemination through a New Central Transparency Platform, MSRB Notice 2013-14 (Jul. 31, 2013); Request for Comment on More Contemporaneous Trade Price Information Through a New Central Transparency Platform, MSRB Notice 2013-02 (Jan. 17, 2013). See also SEC Report on the Municipal Securities Market, at pp. 117, 141 (Jul. 31, 2012) (noting transparency initiatives), available at <http://www.sec.gov/news/studies/2012/munireport073112.pdf>.

<sup>4</sup> MSRB Rule G-18 currently provides that:

[e]ach 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.

<sup>5</sup> MSRB Rule G-30 currently provides that:

(a) Principal Transactions. No broker, dealer or municipal securities dealer shall purchase municipal securities for its own account from a customer or sell municipal securities for its own account to a customer except at an aggregate price (including any mark-down or mark-up) that is fair and reasonable, taking into consideration all relevant factors, including the best judgment of the broker, dealer or municipal securities dealer as to the fair market value of the securities at the time of the transaction and of any securities exchanged or traded in connection with the transaction, the expense involved in effecting the transaction, the fact that the broker, dealer, or municipal securities dealer is entitled to a profit, and the total dollar amount of the transaction.

dealers to trade with customers at fair and reasonable prices and to exercise diligence in establishing the market value of municipal securities and the reasonableness of their compensation.<sup>6</sup> A best-execution standard generally requires dealers to use reasonable diligence to ascertain the best market for the subject security and to buy or sell in that market so that the resultant price to the customer is *as favorable as possible* under prevailing market conditions. While Rules G-18 and G-30 contain substantive pricing standards, under which dealers must (among other things) use reasonable diligence in determining a security's fair market value,<sup>7</sup> a best-execution standard is an order-handling and transaction-execution standard, under which the goal of the dealer's reasonable diligence is to provide the customer the most favorable price possible. The establishment of a best-execution standard, however, can be accompanied by risks of impacting liquidity and decreasing dealer participation in the market.

In March 2012, the MSRB expressed concerns (in connection with its rulemaking related to brokers' brokers) that, while its pricing rules require dealers to obtain prices for their customers that are fair and reasonable, those rules do not govern all dealer conduct that would be regulated by an explicit best-execution rule. The MSRB stated at that time that it would consider this issue in connection with its ongoing review of its rules.<sup>8</sup> Shortly

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(b) Agency Transactions. No broker, dealer or municipal securities dealer shall purchase or sell municipal securities as agent for a customer for a commission or service charge in excess of a fair and reasonable amount, taking into consideration all relevant factors, including the availability of the securities involved in the transaction, the expense of executing or filling the customer's order, the value of the services rendered by the broker, dealer or municipal securities dealer, and the amount of any other compensation received or to be received by the broker, dealer, or municipal securities dealer in connection with the transaction.

<sup>6</sup> The MSRB has a proposed rule change under review by the SEC which would non-substantively consolidate current MSRB Rules G-18 and G-30 into a single pricing rule, Rule G-30. Proposed Rule Change Consisting of Proposed Revisions to MSRB Rule G-30, on Prices and Commissions and the Deletion of Rule G-18, on Execution of Transactions, SR-MSRB-2014-01 (Jan. 29, 2014), available at <http://www.msrb.org/Rules-and-Interpretations/SEC-Filings/~media/Files/SEC-Filings/2014/SR-MSRB-2014-01.ashx>. The MSRB will conform the changes proposed here as appropriate depending on future actions taken on the pending fair-pricing proposal.

<sup>7</sup> See MSRB Notice 2004-03 (Jan. 26, 2004).

<sup>8</sup> See "Notice of Filing of a Proposed Rule Change Consisting of Proposed Rule G-43, on Broker's Brokers; Proposed Amendments to Rule G-8, on Books and Records, Rule G-9, on Record Retention, and Rule G-18, on Execution of Transactions; and a Proposed Interpretive Notice on the Duties of Dealers that Use the Services of Broker's Brokers," Exchange Act

thereafter, in July 2012, the Securities and Exchange Commission (SEC or Commission) issued its *Report on the Municipal Securities Market* (SEC Report).<sup>9</sup> The SEC Report contained a number of recommendations that the SEC concluded should be considered for improvement of the municipal securities market, including possible legislative reforms by Congress, possible steps to be taken by the SEC itself, possible voluntary initiatives by market participants and possible measures to be undertaken by the MSRB. Some of those measures were ways in which the MSRB could consider buttressing existing pricing standards, including establishing a best-execution obligation and providing guidance to dealers on how best-execution concepts would be applied to municipal securities transactions.<sup>10</sup>

In April 2013, the SEC hosted a roundtable on fixed income markets, in which various market participants, academics and the MSRB participated.<sup>11</sup> The roundtable generated important and useful dialogue about the potential application of best-execution concepts to the municipal securities market, including the roles of broker's brokers and dealer inventories in the market, and the lack of statistical data on the quality of executions of transactions.<sup>12</sup>

In August 2013, the MSRB published a concept proposal on best execution, requesting comment on whether a new MSRB rule should apply best-execution concepts to the municipal securities market.<sup>13</sup> The Concept Proposal specifically raised the issue of whether a best-execution requirement would effectively buttress existing MSRB fair-pricing obligations. In addition, the MSRB observed that, although the Financial Industry Regulatory Authority's (FINRA) best-execution rule, FINRA Rule 5310 (Best Execution and Interpositioning), applies to non-municipal fixed income

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Release No. 66625, SR-MSRB-2012-04, at pp. 29-30 (Mar. 20, 2012), 77 FR 17548 (Mar. 26, 2012), available at <http://www.sec.gov/rules/sro/msrb/2012/34-66625.pdf>.

<sup>9</sup> SEC Report, *supra* n. 3.

<sup>10</sup> *Id.* at pp. 149-50.

<sup>11</sup> Roundtable on Fixed Income Markets, Securities and Exchange Commission, April 16, 2013; <http://www.sec.gov/news/otherwebcasts/2013/fixed-income-roundtable-041613.shtml>.

<sup>12</sup> *See id.*

<sup>13</sup> Request for Comment on Whether to Require Dealers to Adopt a "Best Execution" Standard for Municipal Securities Transactions, MSRB Notice 2013-16 (Aug. 6, 2013) (Concept Proposal).

securities,<sup>14</sup> there are certain concepts and requirements in FINRA Rule 5310 that may be more applicable to transactions in equity securities, particularly those that are a part of the electronically interconnected national market system.

After carefully considering all of the comments, the MSRB has determined to propose a best-execution rule that is generally harmonized with FINRA Rule 5310 but tailored to the characteristics of the municipal securities market. The MSRB has also determined to propose an exception from the best-execution rule for all transactions with SMMPs.<sup>15</sup> While an objective of draft Rule G-18 would be to provide a customer with a price that is as favorable as possible under prevailing market conditions, the best-execution requirement generally would target the process by which dealers handle orders and execute transactions, and would complement and buttress the MSRB's existing fair-pricing rules.

## Summary of Draft Rule G-18 and Draft Amendments to Proposed Rule G-48

The essence of draft Rule G-18, like FINRA Rule 5310, is the requirement that dealers use reasonable diligence in seeking to obtain for their customer transactions the most favorable terms available under prevailing market conditions. Under draft Rule G-18, dealers are required to use reasonable diligence in informing themselves of the most favorable terms available, among the variety of markets in which a securities transaction could be

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<sup>14</sup> Under FINRA Rule 0150 (Application of Rules to Exempted Securities Except Municipal Securities), FINRA rules do not apply to transactions in, and business activities relating to, municipal securities. Accordingly, FINRA Rule 5310 on best execution does not apply to the municipal securities market.

<sup>15</sup> Current MSRB interpretive guidance under Rule G-17 defines an SMMP as "an institutional customer of a dealer that: (1) the dealer has a reasonable basis to believe is capable of evaluating market risks and market value independently, both in general and with regard to particular transactions in municipal securities, and (2) affirmatively indicates that it is exercising independent judgment in evaluating the recommendations of the dealer." Restated Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals (Jul. 9, 2012).

Proposed MSRB Rule G-48 is currently under review by the SEC and, if approved, would codify existing interpretive guidance under Rule G-17 that modifies dealers' obligations under several other MSRB rules when dealing with SMMPs. See Exchange Act Release No. 70593 (Oct. 1, 2013); 78 FR 62867 (Oct. 22, 2013). These modifications include a reduced pricing obligation when dealing with SMMPs as compared with what would otherwise apply under Rule G-18. The MSRB will conform the changes proposed here as appropriate depending on future actions taken on pending proposed Rule G-48.

executed, and then execute the transaction in the best market to provide the most favorable price possible to the customer. Under the draft amendments to proposed Rule G-48, the best-execution obligations under the draft rule do not apply to transactions with SMMPs.

Draft Rule G-18, as discussed in detail below, includes particular rule language and supplementary material designed to tailor best-execution obligations to the characteristics of the municipal securities market and to provide guidance on how best-execution concepts apply to municipal securities transactions. This tailoring includes accommodations for situations involving less availability of quotations and relevant pricing information, the role of broker's brokers in providing liquidity, the role of dealers' inventories in providing liquidity, the variance in the nature of dealers' municipal securities business, and the lack of standardized and publicly reported statistical data regarding the quality of executions of municipal securities transactions. While the draft rule gives due consideration to the existing market structure and other current market realities, it is nevertheless designed to be sufficiently flexible to allow both the evolution of the market's structure and future developments in applied technology.

### **Request for Comment**

Paragraph (a) of draft Rule G-18 is the core provision which requires dealers to use reasonable diligence to ascertain the best market for the subject security and to buy or sell in that market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. Paragraph (a), like FINRA Rule 5310(a)(1), includes a non-exhaustive list of factors that a dealer must consider when exercising this diligence. The factors that must be considered are: the character of the market for the security, the size and type of transaction, the number of markets checked, the information reviewed to determine the current market for the subject security or similar securities, the accessibility of quotations, and the terms and conditions of the customer's inquiry or order.

To tailor the draft rule to the municipal securities market, paragraph (a) includes a factor that is not listed in the FINRA rule – "information reviewed to determine the current market for the subject security or similar securities." This factor helps guide the use of reasonable diligence when, for example, there are no available quotations for a security. Moreover, this factor takes into account that dealers may use information about similar securities and other reasonably relevant information.



Paragraph (b) of draft Rule G-18 prohibits a dealer from interjecting a third party between itself and the best market for the security in a manner inconsistent with paragraph (a), a practice known as “interpositioning.” Historically, in non-municipal securities transactions, a dealer was required to demonstrate that the use of a third party *reduced* the costs of the transaction to the customer. Over time, however, that standard came to be seen as overbroad. Consequently, under the current FINRA rule, the use of a third party is allowed so long as it is not *detrimental* to the customer.<sup>16</sup> Consistent with this current policy, and in light of the role of broker’s brokers in the municipal securities market in providing liquidity, paragraph (b) does not prohibit the use of a broker’s broker, unless it would be inconsistent with the best-execution obligation in paragraph (a). For example, if a dealer already definitively knew which was the best market for the security, but then unnecessarily interjected a broker’s broker between itself and that market causing an increase in the customer’s costs, the dealer would violate the rule.

Also in light of the role of broker’s brokers in the municipal securities market, the draft rule does not include a provision like that in FINRA Rule 5310(b) which requires dealers to show why it was reasonable to use a broker’s broker.<sup>17</sup> In this way, the draft rule is consistent with the MSRB’s objective, supported by commenters on the Concept Proposal, of developing a principles-based rule that does not favor any particular venue over another (beyond the merits of the execution quality available at any venue). Moreover, broker’s brokers in the municipal securities market must comply with MSRB Rule G-43 (Broker’s Brokers), which operates to address investor-protection issues without additional requirements being imposed by the draft rule.

Paragraph (c) of draft Rule G-18, like its counterpart in FINRA Rule 5310(e), specifies that the draft rule applies to both principal and agency transactions.

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<sup>16</sup> In approving provisions in the precursor to the current FINRA rule, the SEC noted that “the cost to the customer under the proposed rule will ‘remain a crucial factor in determining whether a member has fulfilled its best execution obligations under [the rule],’ including transactions involving interposed third parties.” See Exchange Act Release No. 60635 (Sept. 8, 2009), 74 FR 47302 (Sept. 15, 2009) at 47303. The Commission also noted that interpositioning “‘that is unnecessary or violates a member’s general best execution obligations – either because of unnecessary costs to the customer or improperly delayed executions – would still be prohibited.’” *Id.*

<sup>17</sup> FINRA Rule 5310(b) provides: “When a member cannot execute directly with a market but must employ a broker’s broker or some other means in order to ensure an execution advantageous to the customer, the burden of showing the acceptable circumstances for doing so is on the member.”

It also specifies that best-execution obligations are distinct from dealers' pricing obligations under other rules.

Paragraph .01 of the Supplementary Material makes clear that the draft rule is not intended to be a substantive pricing standard but an order-handling standard for the execution of transactions. The paragraph explains that the principal purpose of the draft rule is to promote dealers' use of reasonable diligence in obtaining the best price for customers under prevailing market conditions. This is accomplished through the rule's general requirements of the use of, and periodic improvement of, sound procedures. The paragraph expressly provides that, as characteristic of any reasonableness standard, a failure to have *actually* obtained the most favorable price will not necessarily mean that the dealer failed to act *reasonably* under the circumstances.

Paragraph .02 of the Supplementary Material provides, like FINRA Rule 5310(c), that a failure to maintain adequate resources (*e.g.*, staff or technology) cannot justify executing away from the best available market. This paragraph, however, includes an acknowledgment that dealers differ in the nature of their municipal securities business. This acknowledgment is included because the MSRB does not believe that the rule should impose a "one-size-fits-all" standard for "adequate resources."

Paragraph .03 of the Supplementary Material provides that dealers must make every effort to execute customer transactions in a reasonably timely manner, taking into account prevailing market conditions. This is a modification of the "fully and promptly" standard used in paragraph .01 of the Supplementary Material of FINRA Rule 5310, which standard is generally understood to be more applicable to equity-market transactions that typically are executed in seconds or less.

Paragraph .04 of the Supplementary Material defines the term "market" for purposes of draft Rule G-18, including the rule's core provision requiring the exercise of reasonable diligence in ascertaining the "best market" for the security. The definition specifically includes "alternative trading systems or platforms," "broker's brokers," and "other counterparties, which may include the dealer itself as principal." The purpose of this language is to tailor the definition of the critical term "market" to the characteristics of the municipal securities market and to provide flexibility for future developments in both market structure and technology. For example, the language expressly recognizes that the executing dealer itself, acting in a principal capacity, may

be the best market for the security.<sup>18</sup> This could occur where a dealer, through its use of reasonable diligence in accordance with the draft rule, ultimately finds that transacting through its own inventory would result in the most favorable price possible to the customer under prevailing market conditions. This tailoring is in recognition of the role of dealer inventories in providing liquidity in the municipal market.

Paragraph .05 of the Supplementary Material is intended to avoid the imposition of redundant or unnecessary obligations on a dealer involved in a transaction when another dealer appropriately bears best-execution obligations. The paragraph provides that a dealer's duty to provide best execution to customer orders received from another dealer arises only when an order is routed from the other dealer to the dealer for handling and execution. The best-execution obligation does not apply to a dealer when another dealer is simply executing a customer transaction against that dealer's quote.

Paragraph .06 of the Supplementary Material addresses transactions involving securities for which there is limited pricing information or quotations. It requires each dealer to have written policies and procedures that address how its best-execution determinations will be made for such securities, and to document its compliance with those policies and procedures. The paragraph states that a dealer generally should seek out other sources of pricing information and potential liquidity, including other dealers that the dealer previously has traded with in the security. The paragraph also states that a dealer generally should analyze other data to which it reasonably has access.

Paragraph .07 of the Supplementary Material allows a customer to opt out of the best-execution framework for any transaction to the extent it chooses. The paragraph provides that, if a dealer receives an unsolicited instruction from a customer concerning any aspect of the execution of the customer's transaction, the dealer is not required to make a best-execution determination that would supersede the customer's specific instruction. Under the draft rule, a blanket instruction obtained through means like account-opening documents would not qualify as an "unsolicited" instruction.

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<sup>18</sup> FINRA Rule 5310 also allows the dealer acting in a principal capacity to be the "best market," but does not have express language to that effect. Paragraph .09 of the Supplementary Material of the FINRA Rule, in discussing the requirements to review execution quality, contemplates a firm's "internalization" of customer orders.

Paragraph .08 of the Supplementary Material specifies dealers' minimum obligations concerning the periodic review of their policies and procedures for ascertaining the best market. This paragraph is a departure from the FINRA rule's requirement that dealers engage in "regular and rigorous review" of execution quality, on at least a quarterly basis, assessing any material differences among markets based on a highly detailed list of factors. The MSRB does not believe that dealers in municipal securities currently have access to data similar to that used by broker-dealers in other contexts and has modified the review requirement accordingly.

The draft rule reflects the broad principle that a dealer's policies and procedures must be reasonably designed to achieve best execution. The draft rule, however, allows for the future evolution of the market by requiring dealers' reviews to take account of: changes in market structure, new entrants, the availability of additional pre-trade and post-trade data and the availability of new technologies. Finally, the draft rule does not require in all cases that dealers conduct reviews on at least a quarterly basis. It instead requires the frequency of reviews to be reasonably related to the nature of the dealer's business, including its level of sales and trading activity. Under this standard, smaller dealers that handle customer transactions in municipal securities infrequently may not, depending on all of the facts and circumstances, be required to conduct reviews of their policies and procedures four times each year.

Paragraph .09 of the Supplementary Material exempts transactions in municipal fund securities from the application of the draft rule.

The draft amendments to proposed Rule G-48 provide that a dealer shall not have any obligations under Rule G-18 to use reasonable diligence to ascertain the best market for the subject security and buy or sell in that market so that the resultant price to the SMMP is as favorable as possible under prevailing market conditions.

## **Economic Analysis**

The MSRB recently adopted a policy to more formally integrate economic analysis into its rulemaking process. Under the policy, the MSRB should, prior to proceeding with a rulemaking, evaluate the need for the draft rule and determine whether the rule as drafted will, in its judgment, meet that need. The MSRB also should identify, prior to proceeding with a rulemaking, data and other information it would need in order to make an informed judgment about the potential economic consequences of the draft rule. In addition, the MSRB should make a preliminary identification of both relevant baselines

and reasonable alternatives to the draft rule. Finally, the MSRB should consider the potential benefits and costs of the draft rule and the main alternative regulatory approaches.

**1. The need for draft Rule G-18 and how the draft rule will meet that need.**

The MSRB has previously observed a need to improve the quality of execution of transactions beyond the baseline requirement of assuring a fair and reasonable price for customer transactions under existing rules.<sup>19</sup> In adopting MSRB Rule G-43, the MSRB recognized the importance of providing for price improvement for retail investors by establishing standards of practice for broker's brokers and dealers that effect transactions through broker's brokers.<sup>20</sup> Comments from industry participants during that rulemaking process suggested varying practices and understanding of the importance of price improvement for customer transactions in the context of their overall fair-pricing obligations under existing MSRB rules. The MSRB noted that it would take under advisement the question of whether there should exist an explicit best-execution obligation under its rules. Shortly thereafter, the SEC recommended in the SEC Report that the MSRB consider possible rule changes that would require dealers to seek "best execution" of customer orders in connection with municipal securities transactions. In addition, the SEC Report recommended that the MSRB provide guidance to dealers on how "best execution" concepts would be applied in connection with transactions in municipal securities.

The draft rule articulates a best-execution standard for dealers of municipal securities that is broadly consistent with existing standards of execution for equities and corporate debt securities transactions. The principal purpose of this rule is to promote, for customer transactions, dealers' use of reasonable diligence in ascertaining the best market and obtaining the most favorable price possible under prevailing market conditions.

The ultimate objective of the draft rule is to use the best-execution standard to promote higher quality trade executions for customers engaging in municipal securities transactions. The draft rule promotes dealers' exercise of reasonable diligence through the use of, and periodic review and potential improvement of, sound procedures for the execution of customers' transactions. The draft rule targets the process by which firms handle orders

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<sup>19</sup> See *supra* n. 8.

<sup>20</sup> See *id.*

and is complementary to current municipal securities dealer obligations for reasonable diligence and fair pricing. Such a process includes dealers' periodic reviews of their written policies and procedures for the executions of customer transactions.

Furthermore, draft Rule G-18 furthers a goal to harmonize MSRB rules with analogous rules of other securities regulators, to the extent appropriate given the nature of the municipal securities market, to help ensure that a consistent standard is applied to both the execution of municipal securities transactions and the execution of transactions in other types of securities. This could promote more effective and efficient compliance by dealers and examination and enforcement by enforcement authorities. Unlike in the equities and corporate fixed income markets, dealers effecting municipal securities transactions do not have an explicit duty to seek "best execution" for customer orders by evaluating where, among the variety of venues at which municipal securities may be executed, the most favorable price for the customer might reasonably be obtained. Draft Rule G-18 would establish such standards for the municipal securities market.

Thus, by articulating a best-execution standard for dealers of municipal securities, the draft rule addresses the need for an execution standard that promotes execution quality in a manner that is broadly consistent with the execution standards applied to customer transactions in other types of securities markets. The draft rule also addresses the need of dealers for guidance on how best-execution concepts would be applied to municipal securities transactions.

## **2. Relevant baselines against which the likely economic impact of elements of the draft rule can be measured**

To evaluate the potential impact of the draft rule's requirements, a baseline, or baselines, must be established as a point of reference. The analysis proceeds by comparing the expected state with the draft rule in effect to the baseline state prior to the rule taking effect. The economic impact of the draft rule is measured as the difference between these two states.

One baseline that can be used to evaluate the impact of the draft rule is the current state under existing MSRB Rules G-18 and G-30. These rules generally require dealers to trade with customers at fair and reasonable prices and to exercise diligence in establishing the market value of municipal securities and the reasonableness of their compensation.

Another baseline for dealers that are also subject to FINRA rules is FINRA Rule 5310 (Best Execution and Interpositioning). That subset of dealers currently must have systems in place to comply with a best-execution obligation for equity and non-municipal fixed-income securities.

### **3. Identifying and evaluating reasonable alternative regulatory approaches.**

The MSRB policy on economic analysis in rulemaking recommends that reasonable potential alternatives to the draft rule should be identified and discussed. In addition to the alternatives considered below, the MSRB also can invite public comment to suggest alternative regimes as well as comments on the potential costs and benefits of alternative regimes.

One alternative to the draft rule would be for the MSRB not to engage in additional rulemaking, and thus, not establish an explicit best-execution standard. Under this alternative, execution standards for customer transactions in the municipal securities market would remain potentially inconsistent with the execution standards in other securities markets. Thus, some dealers may not seek further price improvement for their customers once they have determined that they have been able to achieve a fair and reasonable price for a municipal security.

Another alternative would be to completely adopt the FINRA standard of best execution embodied in FINRA Rule 5310. Certain concepts and requirements in FINRA Rule 5310, however, appear more appropriate for equity securities, particularly those that are part of the national market system. The draft rule has been designed to reflect the characteristics of the market for municipal securities and therefore differs from the FINRA rule in important ways.

Although there may be advantages for the administration of compliance programs from having a completely uniform best-execution standard across all securities markets, there may also be costs to using a single standard that does not account for unique characteristics of the municipal securities market.

### **4. Assessing the benefits and costs, both quantitative and qualitative, of the draft rule and the main alternative regulatory approaches.**

The MSRB policy on economic analysis in rulemaking provides for consideration of the likely economic consequences of the draft rule, against the context of the economic baselines discussed above.

A threshold matter for the MSRB to address is whether the costs and benefits of the draft rule can be reasonably quantified. If not, MSRB policy would require that an explanation be offered as to the reasons why quantification is not possible. In evaluating the economic impact of the draft rule, it would be helpful to have estimates or empirical evidence from market participants or the research community of likely improvements in the quality of executions for customer transactions relative to the baseline. It would also be helpful to have estimates or empirical evidence from market participants or the research community of the costs likely to be incurred by dealers from implementing and maintaining a compliance program with respect to the draft rule's approach for applying best-execution principles. Input from commenters on this notice should include such estimates or empirical evidence to the extent possible, which the MSRB would take into account in finalizing its economic analysis and making its final determination regarding whether to propose the draft rule to the SEC for approval. However, the MSRB is currently not aware of any reasonably reliable estimates or reasonably relevant empirical evidence that is publicly available and would assist in quantifying such costs and benefits, and therefore quantifying the likely economic effects of the draft rule is currently not possible. If the draft rule is adopted, sufficient data may eventually be generated that would allow for an after-the-fact empirical evaluation of the draft rule's impact. Requests for public comment may provide some additional insight into the draft rule's likely dollar costs and benefits.

### **Benefits**

A principal potential benefit of the draft rule's explicit best-execution requirement is that it could reinforce the existing fair-pricing obligations of dealers and could improve execution quality for municipal securities investors. The draft rule could foster price competition among dealers and result in reduced effective spreads and reduced transaction costs for market participants. It is possible, however, that the improvements on each individual transaction may be small, even if the aggregate improvement across all transactions were large.

Another potential benefit from the draft rule comes from detailed guidance to dealers on how best-execution concepts would be applied in connection with transactions in municipal securities. The draft rule, by providing related guidance with respect to best-execution requirements, provides a potential benefit to dealers of municipal securities who could otherwise face greater uncertainty about whether and how to apply best-execution concepts to municipal securities transactions to complement their existing fair-pricing duties.



An additional benefit potentially accruing from the draft rule comes from articulating a best-execution standard for dealers of municipal securities that is broadly consistent with existing standards of execution for equities and corporate debt securities transactions. Consistency in the application of execution standards across different types of securities transactions may be a benefit to those dealers who execute customer transactions in different markets. The benefit to these dealers would come from having similar compliance standards across markets, which could reduce costs that might otherwise be incurred from complying with multiple standards.

### **Costs**

In this section we analyze the potential costs of the draft rule relative to the appropriate baseline. Our preliminary analysis does not consider all the costs associated with the draft rule, but instead focuses on the incremental costs attributable to the draft rule's requirements that exceed the baseline case. The costs associated with the baseline case are in effect subtracted from the costs associated with the draft rule in order to isolate the costs attributable to the incremental requirements attributable to the draft rule.

If a best-execution standard were adopted, dealers would need to establish or revise compliance policies and written supervisory procedures, as well as implement additional monitoring and surveillance. This additional surveillance element would result in costs related to the adoption (and perhaps creation) of new technology systems. Moreover, a review of practices related to best execution would need to occur on a periodic basis.

The costs associated with requirements of the draft rule likely would be most pronounced for those dealers that would be required to implement a compliance system for the first time. These dealers would include the subset of dealers that are not subject at all to FINRA's best-execution rule. These "start-up" costs may be significant. These costs may include seeking the advice of legal and compliance professionals to establish a compliance system. In addition, once a compliance system was implemented, or enhanced, dealers of municipal securities would incur recurring costs of maintaining an ongoing program. For those dealers subject to FINRA Rule 5310, the incremental costs that may be required to adapt existing systems to transactions in municipal securities may be relatively less significant.

Some of the costs associated with compliance with the draft rule are reduced in the aggregate due to the exception for transactions with SMMPs, compared to a scenario in which the draft rule did not except those transactions.

**Effect on Competition, Efficiency and Capital Formation**

It is possible that the costs associated with the compliance and supervisory requirements of the draft rule relative to the baseline may lead some dealers of municipal securities to consolidate with other dealers. For example, some dealers may determine to consolidate with other dealers in order to benefit from economies of scale (*e.g.*, by leveraging existing compliance resources of a larger firm) rather than to incur separately the costs associated with the draft rule. It appears, at this preliminary stage of the rulemaking process, however, that the costs associated with the draft rule are unlikely to be of such a magnitude as to significantly affect consolidation decisions on a broad market basis. Moreover, many smaller firms may rely on other dealers to handle execution of their customers' orders and may leverage upon the best execution and periodic reviews of the executing broker as a means of ensuring that the firm is meeting its best-execution obligations.

It is also possible that a best-execution rule would affect the dimensions, or attributes, upon which market participants compete. A rule that focuses on a single execution attribute, such as a price, could diminish competition for other execution attributes that might be valued by investors, such as speed of execution.

In addition, to the extent dealers might consider fulfilling their best-execution obligations to be more difficult with respect to some securities, such as those that are less widely traded, the rule could have an effect on the relative marketability of such securities.

In addition to any other subject that commenters may wish to address related to draft Rule G-18, the draft amendments to proposed Rule G-48, and the economic analysis, the MSRB seeks comment on the specific questions below. The MSRB particularly requests statistical, empirical, and other data that may support commenters' views or support or refute the views or assumptions contained in this request for comment.

- 1) One goal of requiring that dealers seek best execution of customer transactions in municipal securities is to help customers obtain the most favorable price possible under prevailing market conditions. Could this goal be better achieved through alternative regulatory measures such as encouraging interdealer competition for customer orders or by requiring greater transparency with respect to the quality of executions obtained by dealers?

- 2) Is the desire to have a consistent, explicit best-execution standard applied to both the execution of municipal securities transactions and the execution of other types of securities a worthwhile goal?
- 3) To what extent would the draft rule result in increased transactional efficiency?
- 4) What additional compliance and supervision costs, relative to the existing baseline, would be incurred by dealers to comply with a best-execution requirement?
- 5) What additional costs would be incurred by dealers to periodically review policies and procedures related to best execution?

February 19, 2014

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## Text of Proposed Amendments<sup>21</sup>

### Rule G-18: Best Execution ~~Execution of Transactions~~

(a) In any transaction in a municipal security for or with a customer or a customer of another broker, dealer, or municipal securities dealer (“dealer”), a dealer must use reasonable diligence to ascertain the best market for the subject security and buy or sell in that market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. Among the factors that will be considered in determining whether a dealer has used “reasonable diligence,” with no single factor being determinative, are:

- (1) the character of the market for the security (e.g., price, volatility, and relative liquidity);
- (2) the size and type of transaction;
- (3) the number of markets checked;
- (4) the information reviewed to determine the current market for the subject security or similar securities;
- (5) the accessibility of quotations; and
- (6) the terms and conditions of the customer’s inquiry or order, including any bids or offers, that result in the transaction, as communicated to the dealer.

(b) In any transaction for or with a customer or a customer of another dealer, a dealer must not interject a third party between itself and the best market for the subject security in a manner inconsistent with paragraph (a) of this rule.

<sup>21</sup> Underlining indicates new language; strikethrough denotes deletions.

(c) The obligations described in paragraphs (a) and (b) above apply to transactions in which the dealer is acting as agent and transactions in which the dealer is acting as principal. These obligations are distinct from the fairness and reasonableness of commissions, markups or markdowns, which are governed by Rule G-30.

**---Supplementary Material:**

**.01 Purpose.** The principal purpose of this rule is to promote, for customer transactions, dealers' use of reasonable diligence in ascertaining the best market and obtaining the most favorable price possible under prevailing market conditions. A failure to have actually obtained the most favorable price will not necessarily mean that the dealer failed to use reasonable diligence.

**.02 Maintenance of Adequate Resources.** A dealer's failure to maintain adequate resources (e.g., staff or technology) is not a justification for executing away from the best available market. The level of resources required to be maintained by a particular dealer, however, will vary depending on the nature of the dealer's municipal securities business, taking into account its level of sales and trading activity.

**.03 Execution of Customer Transactions.** A dealer must make every effort to execute a customer transaction in a reasonably timely manner, taking into account prevailing market conditions. In certain market conditions a dealer may need more time to use reasonable diligence to ascertain the best market for the subject security.

**.04 Definition of "Market."** The term "market" or "markets," for the purposes of this rule, unless the context requires otherwise, encompasses a variety of different venues, including but not limited to broker's brokers, alternative trading systems or platforms, or other counterparties, which may include the dealer itself as principal. The term is to be construed broadly, recognizing that municipal securities currently trade over the counter without a central exchange or platform. This expansive interpretation is meant both to inform dealers as to the breadth of the scope of venues that must be considered in the furtherance of their best-execution obligations and to promote fair competition among dealers (including broker's brokers), alternative trading systems and platforms, and any other venue that may emerge, by not mandating that certain trading venues have less relevance than others in the course of determining a dealer's best-execution obligations.

**.05 Best Execution and Executing Brokers.** A dealer's duty to provide best execution in any transaction "for or with a customer of another dealer" does not apply in instances when the other dealer is simply executing a customer transaction against the dealer's quote. A dealer's duty to provide best execution to customer orders received from other dealers arises only when an order is routed from another dealer to the dealer for handling and execution.

**.06 Securities with Limited Quotations or Pricing Information.** Although the best-execution requirements in this rule apply to transactions in all municipal securities, markets for municipal securities may differ dramatically. One of the areas in which a dealer must be especially diligent in ensuring that it has met its best-execution obligations is with respect to customer transactions involving securities for which there is limited pricing information or quotations available. Each dealer must have written policies and procedures in place that address how the dealer will make its best-execution determinations with respect to such a security in the absence of pricing information or multiple quotations and must document its compliance with those policies and procedures. For example, a dealer generally should seek out other sources of pricing information and potential liquidity for such a security, including other dealers that the dealer previously has traded with in the security. Additionally, a dealer generally should, in determining whether the resultant price to the customer is as favorable as possible under prevailing market conditions, analyze other data to which it reasonably has access.

**.07 Customer Instructions Regarding Handling of Bids or Offers.** If a dealer receives an unsolicited instruction from a customer concerning any aspect of the execution of the customer's transaction, the dealer is not required to make a best-execution determination that would supersede the customer's specific instruction. Dealers, however, are still required to process that customer's transaction in a reasonably timely manner and in accordance with the terms of the customer's bid or offer.

**.08 Review of Execution Quality.**

(a) A dealer must, at a minimum, conduct periodic reviews of its policies and procedures for determining the best available market for the executions of its customers' transactions. While no specific interval is required, a dealer must conduct these reviews at a frequency reasonably related to the nature of its business, including but not limited to its level of trading activity. In conducting its periodic reviews, a dealer must assess whether its policies and procedures are reasonably designed to achieve best execution, taking into account changes in market structure, new entrants, the availability of additional pre-trade and post-trade data, and the availability of new technologies, and to make promptly any necessary modifications to such policies and procedures as may be appropriate in light of such reviews.

(b) A dealer that routes its customers' transactions to another dealer that has agreed to handle those transactions as agent or riskless principal for the customer (e.g., a clearing firm or other executing dealer) may rely on that other dealer's periodic reviews as long as the results and rationale of the review are fully disclosed to the dealer and the dealer periodically reviews how the other dealer's review is conducted and the results of the review.

**.09 Exemption for Municipal Fund Securities.** The provisions of this rule do not apply to transactions in municipal fund securities.

~~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.~~

\* \* \* \* \*

**Rule G-48: Transactions with Sophisticated Municipal Market Professionals**

A broker, dealer, or municipal securities dealer's obligations to a customer that it reasonably concludes is a Sophisticated Municipal Market Professional, or SMMP, shall be modified as follows:

(a) - (d) No change.

(e) *Best Execution*. The broker, dealer, or municipal securities dealer shall not have any obligation under Rule G-18 to use reasonable diligence to ascertain the best market for the subject security and buy or sell in that market so that the resultant price to the SMMP is as favorable as possible under prevailing market conditions.

## **Alphabetical List of Comment Letters on Notice 2014-02 (February 19, 2014)**

1. Bond Dealers of America: Letter from Michael Nicholas, Chief Executive Officer, dated March 21, 2014
2. City of New York, Office of the Comptroller: Letter from Scott M. Stringer, New York City Comptroller, dated March 21, 2014
3. Coastal Securities: Letter from Chris Melton, Executive Vice President, dated March 21, 2014
4. Interactive Data: Letter from Andrew Hausman, President, dated March 21, 2014
5. National Association of Independent Public Finance Advisors: Letter from Jeanine Rodgers Caruso, President, dated March 21, 2014
6. NYSE Euronext: Letter from Martha Redding, Chief Counsel, dated March 31, 2014
7. Regional Brokers, Inc.: Letter from H. Deane Armstrong, CCO
8. Securities Industry and Financial Markets Association: Letter from David L. Cohen, Managing Director, Associate General Counsel, dated March 13, 2014
9. Wells Fargo Advisors, LLC: Letter from Robert J. McCarthy, Director of Regulatory Policy, dated April 2, 2014
10. Wulff, Hansen & Co.: Letter from Chris Charles, President, dated March 21, 2014

March 21, 2014

VIA ELECTRONIC MAIL

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

*RE: MSRB Notice 2014-02 February 19, 2014) – Request for Comment on  
Draft Best-Execution Rule, Including Exception for Transactions with  
Sophisticated Municipal Market Professionals*

Dear Mr. Smith:

On behalf of the Bond Dealers of America (“BDA”), I am pleased to submit this letter in response to Municipal Securities Rulemaking Board (“MSRB”) Notice 2014-02 (“Notice”) seeking comment on draft MSRB Rule G-18 (the “Draft Rule”) on best execution of transactions in municipal securities. BDA is the only DC-based group representing the interests of middle-market securities dealers and banks focused on the U.S. fixed income markets. Accordingly, we believe that we uniquely offer insight into how a best execution rule would impact the middle-market securities dealers who provide essential liquidity to the municipal securities through their specialization of regional and unique credits.

***Inconsistency with FINRA Rule 5310.*** The BDA agrees with the MSRB that, as a general matter, the way that FINRA Rule 5310 regulates the execution of transactions of unquoted debt securities is how MSRB Rule G-18 should regulate the execution of transactions of municipal securities. We are concerned, though, that this is not what the Draft Rule does. While the text of Draft Rule G-18 gives an appearance that it regulates the trading of municipal securities like FINRA Rule 5310 regulates the trading of unquoted debt securities, there is a subtle but significant shift in the Draft Rule that would change that.

Within the Supplemental Material under FINRA Rule 5310, section .03 speaks to how FINRA Rule 5310 applies to unquoted debt securities, and makes a significant allowance for those circumstances. Note .03 under Supplemental Materials reads as follows:

**“.03 Best Execution and Debt Securities.** Rule 5310(a)(1)(D) provides that one of the factors used to determine if a member has



used reasonable diligence in exercising best execution is the “accessibility of the quotation.” In the context of the debt market, this means that, when quotations are available, FINRA will consider the accessibility of such quotations when examining whether a member has used reasonable diligence. For purposes of debt securities, the term “quotation” refers to either dollar (or other currency) pricing or yield pricing. Accessibility is only one of the non-exhaustive reasonable diligence factors set out in Rule 5310(a)(1). ***In the absence of accessibility, members are not relieved from taking reasonable steps and employing their market expertise in achieving the best execution of customer orders.*** (italics added)

In short, Note .03 means that if a dealer has accessibility to a quotation for a debt security, then that accessibility is a major factor in considering whether the dealer exercised reasonable diligence. But, “in the absence of accessibility,” then dealers must take reasonable steps. That is, in the case of unquoted debt securities, dealers really cannot comply with the full text of FINRA Rule 5310 because of the inaccessibility to quotations and thus the Supplemental Materials provide that dealers still need to use reasonable efforts.

As a practical matter, BDA members find that in the case of unquoted debt securities, this requires dealers to maintain policies and procedures that ensure that they are taking reasonable steps in the execution of a transaction. That is, complying with FINRA Rule 5310 in the trading of unquoted debt securities comes down to creating and maintaining reasonable policies and procedures that address the available venues where those debt securities are traded and ensure that the dealer is considering those venues. Further, in examinations, the experience of BDA members is that FINRA examiners evaluate dealers’ compliance with FINRA Rule 5310 on this basis.

While the Draft Rule is modeled after language of FINRA Rule 5310, the Draft Rule does not provide the supplemental material that is necessary to explain how dealers are to comply with a transaction-by-transaction best execution rule in a municipal securities market that is not quoted on a centralized exchange. Yet, unlike the markets that FINRA Rule 5310 was primarily designed to regulate, the municipal securities market consists almost entirely of securities that are like those described in the last sentence of .03 of the supplemental materials of FINRA Rule 5310, where quotes are not accessible. As posited in our October 7, 2013 letter, municipal securities are highly diverse in terms of types of issuers, kinds of credits, sizes of issuers and credit quality. Much of the trading is accomplished by regional dealers who rely upon local knowledge, deal in bonds that trade very infrequently and may ever attract only one bid, and are willing to take bonds into inventory.

Despite these inexorable facts about the municipal market, the Draft Rule provides a new and quite expansive definition of “market”. As a result, BDA members are concerned that a standard that is far more stringent is being applied to the municipal market than what FINRA Rule 5310 applies to unquoted debt securities. At the same time the proposed rule overreaches, broker-dealers do not have a clear understanding of

what they would need to do to comply with the Draft Rule. The following are examples of where the Draft Rule fails to provide adequate guidance sufficient for broker-dealers and examiners alike to understand how to comply:

- (1) Exactly what steps does a dealer need to take to sell municipal securities out of its inventory?
- (2) If a dealer is purchasing a municipal security from a customer, when can a dealer purchase the municipal security into inventory?
- (3) If a dealer is purchasing a municipal security from a customer and intends to place the security out for bid to other dealers, how many dealers does the dealer need to solicit and how much diligence does the dealer need to conduct in order to have confidence that all appropriate dealers are included?
- (4) When does the dealer need to access an alternate trading system?

BDA supports the MSRB developing a rule that imposes on dealers in the municipal securities market the same obligations that dealers have in unquoted debt securities under FINRA 5310, but that is not what the MSRB has done. Instead, the Draft Rule imposes a reasonable diligence standard in an almost entirely unquoted market without the necessary supplemental materials in FINRA Rule 5310 that address unquoted markets. As recommended in our October 7 letter, we believe that requiring the creation and maintenance of policies and procedures is the appropriate way to apply a best execution rule to the municipal securities market, particularly in those instances in which a bond to be sold is thinly quoted. This is consistent with the current manner in which FINRA Rule 5310 applies with respect to debt securities when quotations are not available.

We ask the MSRB to be mindful that dealers already must comply with fair pricing and suitability rules that protect the pricing customers receive on trades. Where dealers effect their trades in the municipal securities market has much less to do with what pricing a customer receives than the proper diligence of a dealer in ensuring that customers received a fair and reasonable price. The rules that are going to protect the pricing customers receive will be the MSRB's fair pricing and suitability rules. These rules, combined with current improvements and future strides in the transparency of the municipal securities market, such as the availability of ATS's, an enhanced, public electronic database through EMMA and possibly, the creation of an index for retail customers, may improve that pricing.

We do not believe that new rules that govern where dealers effect their trades will materially improve pricing – and if the rules are designed improperly, they will actually impair liquidity by forcing small and middle market dealers in lesser-known, thinly traded securities to exit the market.

***SMMPs.*** Consistent with our October 7 letter, BDA members agree with the MSRB's creation of an exception in the Draft Rule for sophisticated municipal market

professional (“SMMPs”). We think that this is very important because SMMPs can have as much if not better access to trading venues and other dealers as the dealers themselves, and do not require the protection of the rule.

***Similar Securities.*** BDA appreciates the MSRB’s recognition of the fact that for some municipal bonds, more than one quotation may not be available. We believe that an approach based upon having policies and procedures is needed in that instance. Responding to the structure of the MSRB proposed rule, however, if the use of “similar securities” as a measure of the market is to be proposed, BDA recommends that the MSRB place a better definition around the term “similar securities” as used in paragraph (a)(4) of the Draft Rule. We believe that the term is not clear and could be misunderstood in examinations. In addition, given the wide array of factors that could be weighed to determine what constitutes a “similar” security -- such as, geographical region, credit type and quality, terms and conditions and maturity -- any definition of “similar securities” should incorporate as an overriding factor the judgment of the dealer in determining the factors that are most relevant in determining whether a given security is similar.

BDA appreciates the efforts by the MSRB to engage broker-dealers in discussion of a best execution rule both through the concept release and proposed rulemaking. We would like to have further discussion and time to consider the proposal beyond what a 30-day window could permit, and are hopeful that the MSRB will allow additional comments and provide further proposals before finalizing a rule. BDA would like to work with the MSRB to ensure that the final rule is in a format that appropriately honors the nature of the municipal market and is as understandable to broker-dealers as it will be to those seeking to enforce the rule. Thank you for the opportunity to submit these comments, and feel free to contact me or my staff with any questions or concerns.

Sincerely,

A handwritten signature in blue ink that reads "Michael Nicholas". The signature is fluid and cursive, with the first name being more prominent.

Michael Nicholas  
Chief Executive Officer



THE CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER  
SCOTT M. STRINGER

March 21, 2014

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

Re: Request for Comment on Draft Rule G-18 on Best Execution

Dear Mr. Smith:

I appreciate the opportunity to provide comments to the Municipal Securities Rulemaking Board (MSRB) on draft Rule G-18, Best Execution of Transactions in Municipal Securities. The Comptroller's Office has reviewed draft Rule G-18, and it is our belief that requiring brokers, dealers, and municipal securities dealers (collectively "dealers") to use reasonable diligence in seeking to obtain for their customer transactions in municipal securities the most favorable terms available under prevailing market conditions will foster a more open, transparent, even-handed market environment for investors – and individual investors in particular – and we support its adoption.

As New York City Comptroller, I serve as the chief fiscal officer of the City of New York. The City's Mayor and Comptroller are jointly responsible for debt of the City and several related debt-issuing entities. Collectively, these issuers make New York City the second largest issuer of municipal debt in the nation, after the State of California. In calendar year 2013, the City and related debt-issuing entities sold over \$11.8 billion of bonds to finance or refinance capital projects, and across our related credits we have over \$100 billion of bonds outstanding. New York City thus needs a large and diverse base of bond purchasers and holders to finance its capital program at attractive interest rates.

Individual investors are particularly significant purchasers of City debt. Throughout the credit crisis of 2008, individual investors provided essential support for the City's bond sales and they have continued to be a key investor segment as institutional demand for municipal bonds has fluctuated. For example, in a \$695 million negotiated sale completed earlier this month, individuals purchased \$278 million or 40% of the total tax-exempt fixed rate offering. It is essential that individual investors have continued confidence in the municipal market.

We are aware that individuals have less access to pricing information than institutions and applaud the MSRB's initiatives to enhance access to municipal market information, especially through EMMA. The City has also taken steps within our powers to be supportive of individual investors:

- Our office created a landing page, [buynycbonds.com](http://buynycbonds.com), linked through our website to promote transparency and consolidate information that investors may find useful.
- In the primary market, we typically sell bonds through negotiation with a syndicate of approximately 25 underwriters and a large selling group, and incorporate a one- or two-day retail order period in each sale. These are days in which bonds are offered only to individual investors ensuring they have access to a good selection of bonds at the same prices as institutional investors.





- We conduct radio advertising campaigns prior to retail order periods to inform as many potential buyers as possible, and have also begun to use social media to further alert investors to bond sales.
- After the order period, we analyze market trade activity to evaluate pricing of new issues and try to monitor whether bonds that were purportedly sold to “going away” investors were instead re-priced and sold in smaller lots.
- We monitor FINRA actions against broker-dealers for mispricing or other municipal securities violations and have taken actions ranging from a follow-up discussions with dealers to ascertain what happened and what new controls they have put in place, to excluding dealers from participating in future sales.

Although the City has had some influence on pricing transparency and market access in the primary market, our ability to increase transparency in the secondary market for municipal securities is limited. Municipal securities are not traded on an exchange; therefore, firm bid and ask quotations are generally unavailable. Individual investors in particular have limited access to information regarding which market participants would be interested in buying or selling municipal securities, and at what prices. We commend the MSRB for introducing policy and procedure guidelines in draft Rule G-18 that will require dealers to address how best execution determinations will be made for securities with limited pricing information or quotations. We believe procedures must evolve that make information that is currently only available to dealers accessible to the broader market.

Notwithstanding our support for draft Rule G-18, we urge the MSRB to consider the potential burden additional compliance could place on small broker-dealers in particular. Regulations are often criticized for taking a costly one-size-fits-all approach. Draft Rule G-18 should maintain elements of flexibility in its policies and procedures in order to reduce compliance costs and allow continued diversity of dealer characteristics.

The City’s Comptroller’s Office sincerely appreciates this opportunity to comment on draft Rule G-18. Our office is an advocate of market transparency and we support the MSRB’s efforts to strengthen municipal market trade execution standards. My staff and I are available and welcome any questions that you may have for us.

Sincerely,



Scott M. Stringer  
New York City Comptroller

March 21, 2014

Ronald W. Smith, Corporate Secretary  
Municipal Securities Rulemaking Board

Re: MSRB Notice 2014-02

Mr. Smith:

Thank you for the opportunity to comment on the proposed amendments to Rule G-18 contained in Notice 2014-02. There is no question that the Board faces a conundrum when the SEC has decided that a best-execution "standard" should apply to the municipal market as a means to improve retail transactional efficiency. The municipal market is not structured (nor can it be) to conform neatly to a "standard" designed for an equity auction market. The Board is proposing to address this conundrum in the same fashion as the (then) NASD when addressing debt market issues in what is now FINRA Rule 5310. In doing so, the Board has acknowledged issues that would be raised in crafting a "best-execution standard" for the municipal market, but has failed to address several other issues that are raised by trying to fit the square peg that is best-execution into the round hole that is the municipal market.

First, does creating a "best execution standard" for municipal transactions address an area that was previously unregulated? And, if it does, how does that help retail investors? Notice 2014-02 states that "In March 2012, the MSRB expressed concerns (in connection with its rulemaking related to brokers' brokers) that, while its pricing rules require dealers to obtain prices for their customers that are fair and reasonable, those rules do not govern all dealer conduct that would be regulated by an explicit best-execution rule." What dealer conduct that is not currently regulated would be regulated by an explicit best-execution rule? The Board does not propose to regulate previously unregulated conduct. Instead, the Board proposes to change currently regulated conduct by applying standards originally intended for an equity auction market to a negotiated market where trades are executed as principal. How does defining potential contra-parties as "markets" in order to craft "best-execution" regulation provide increased market efficiency for retail customers? When the vast majority of sales are out of a dealer's inventory, and many times the only offering for the bonds is coming from the owner, it is certainly unlikely that this will create increased market efficiency, at least for retail purchasers.

Secondly, by adding "the information reviewed to determine the current market for the subject security or similar securities" as a factor used in the determination of whether or not there was an exercise of due diligence, the Board has unnecessarily increased the obligations of a municipal dealer beyond that required of a dealer in corporate securities. The inclusion of "similar securities", while recognizing the fact that there will be many transactions where the current market for the security cannot be ascertained by quotations or other transactions in that security, places a requirement on a dealer to utilize the market of an undefined "similar security" to determine the market price of the subject security. That requirement is not imposed upon corporate dealers. Furthermore, it makes the unsupportable presumption that examiners are competent to judge the sufficiency of the information

related to the similar securities that were reviewed. Permitting or requiring dealers to utilize the prices of “similar securities” does not solve the dilemma created by the fact that the municipal market is illiquid with hundreds of thousands of issues trading on a less than daily basis, while creating a duty that does not exist elsewhere (while the “average” trading frequency may be three times a day, I would wager that median frequency-particularly if one includes issues that did not trade- is considerably less than once daily).

Thirdly, the proposed amendments do not address the issue created by the fact that traders cannot make a two sided market for ninety-nine percent of the municipal issues outstanding. A large number of municipal securities offered for sale are being offered by the only dealer that owns the security. Consequently, any alleged attempt to “use reasonable diligence to ascertain the best market” for a security that dealer owns and has for sale is simply completing a regulatory checklist. No other dealers are willing to make a bona fide offering to sell a municipal security with the full realization that they would be creating a potentially unfillable short position. Therefore, with regard to the vast majority of municipal issues, the only market is that being made by the party owning the securities. The Board addresses the importance of dealer inventory in the municipal market when stating that a dealer could satisfy “best-ex” obligations when “a dealer, through its use of reasonable diligence in accordance with the draft rule, ultimately finds that transacting through its own inventory would result in the most favorable price possible to the customer under prevailing market conditions.” This might adequately address the situation where a client owns a municipal security that the client wishes to sell. It is totally irrelevant where a dealer is offering a unique security out of inventory. Furthermore, the price at which a dealer offers municipal inventory when compared to other allegedly similar securities certainly should be a regulatory pricing issue, not an execution issue. It is a major flaw of the proposal that this issue is not properly addressed.

Thank you again for the opportunity to comment on the proposed new Rule. I look forward to the Board’s final proposal.

Sincerely,

Chris Melton  
Executive Vice President  
Coastal Securities



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March 21, 2014

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

Re: MSRB Notice 2013-16

Dear Mr. Smith:

Interactive Data appreciates the opportunity to respond to the MSRB's request for comment on draft MSRB Rule G-18 on best execution of transactions in municipal securities. We support the objectives of the proposed rule to safeguard investor interests when they transact in the municipal securities market while promoting competition among dealers and improving market efficiency. At the same time, it is important to recognize that many of our clients in the dealer community have invested considerable resources to address the MSRB's existing rules, and compliance with the proposed rule may result in higher costs and other operational complexities related to ambiguous interpretations of the rule. To best achieve the proposed rule's objectives and help mitigate dealer concerns, Interactive Data believes that a best execution rule for municipal bond transactions should provide dealers with additional clarity regarding the use of evaluated pricing in support of best execution compliance.

#### **Interactive Data Corporation's Expertise in the U.S. Municipal Bond Market:**

As a leader in financial information, we have long supported our clients' mission-critical activities in the municipal securities markets. In particular, our Pricing and Reference Data business currently delivers evaluated pricing on more than 1.1 million municipal securities and our descriptive reference data on this asset class covers over 4.6 million municipal securities.<sup>1</sup> These services are complemented by best-in-class fixed income portfolio analytics<sup>2</sup>. Interactive Data Pricing and Reference Data currently counts 40 of the 40 largest wealth managers as customers, as well as 50 of the top 50 U.S. mutual fund companies, 10 of the top 10 custodian banks, 48 of the 50 largest U.S. banks and 32 of the top 50 hedge funds. Our views in this comment letter reflect our unique perspective into and expertise in the U.S. municipal bond market, as well as ongoing dialogue with our clients, business partners and industry associations.

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<sup>1</sup> Interactive Data's reference data coverage counts include instruments that are available in Interactive Data services, some of which may have matured or otherwise be inactive.

<sup>2</sup> BondEdge named among the "Best-in-Class" solutions in the portfolio management category by CEB TowerGroup's Portfolio Modeling and Risk Analytics Technology Assessment, <http://www.interactivedata.com/prdetail.php?pr=318>.



## **Interactive Data's Perspective on Draft MSRB Rule G-18:**

Simply stated, we believe that high-quality evaluated pricing information should play an important role in the best execution compliance efforts of brokers, dealers and municipal securities dealers ("dealers"). We reiterate our position, as outlined in our October 2013 comment letter<sup>3</sup>, that we believe that high-quality evaluated pricing and related transparency services represent important tools that dealers could employ to document and preserve diligence undertaken to substantiate the basis for obtaining a price that is as favorable as possible under prevailing market conditions. Our position is based on the following factors:

- The municipal securities market is likely to remain thinly traded and, as a result, there will be an extensive range of municipal securities without readily available or reliable market quotations. In such cases, evaluated pricing can be an important input for evidencing that a best execution standard has been met.
- High-quality evaluated pricing from independent sources unaffiliated with dealers, like Interactive Data, typically takes multiple sources into account including market participants' assumptions while maximizing the use of relevant observable inputs including quoted prices for similar assets, benchmark yield curves, credit and market corroborated inputs.
- Evaluated pricing helps mitigate conflicts of interest by incorporating information from both the buy-side and the sell-side in order to provide a balanced view into the trading-related activity for a given security.
- Evaluated pricing capabilities are advancing to incorporate continuous pricing processes and support intraday and even streaming delivery of this information, which we believe can further elevate the value of this information in supporting best execution compliance.

We believe that dealers would benefit from clear guidance from the MSRB that they can use evaluated pricing, along with other data, to validate their best execution policies and processes when they transact in the municipal securities marketplace. By specifying that evaluated pricing can help inform best execution assessments, dealers will be better positioned to determine the potential scope and cost of any changes to their existing compliance workflows. In this context, we have highlighted two areas of the proposed rule that the MSRB should further refine to provide firms with the necessary clarity and flexibility to integrate evaluated pricing into their best execution compliance activities:

### **1) "Similar Securities"**

We believe that the following provision in proposed Rule G-18(a)(4), "the information reviewed to determine the current market for the subject security, or similar securities," represents an important factor for determining whether a dealer has used reasonable diligence to ascertain the best market for the subject security and to execute a buy or sell order in that market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. This

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<sup>3</sup> See Interactive Data's comment letter on MSRB Notice 2013-16, [http://www.msrb.org/RFC/2013-16/INTERACTIVE\\_DATA.pdf](http://www.msrb.org/RFC/2013-16/INTERACTIVE_DATA.pdf).

factor is notable, and distinguishable from FINRA Rule 5310, in that it provides firms with flexibility to consider information about similar securities since many municipal securities trade infrequently, if at all, on a daily basis.

- The concept of similar securities is one in which Interactive Data has considerable expertise. Interactive Data determines comparability in several ways including: assessing the subject security against other securities from that same issuer; or other securities from different issuers that may share one or more of the following characteristics: similar maturity, terms and conditions, credit ratings, sector and/or geographical affiliation. Accordingly, we believe that dealers would benefit if the MSRB provided a definition of similar securities that include the non-exhaustive list of criteria cited above.
- We also have developed valuation transparency tools, such as Vantage<sup>SM</sup>, which enable clients to view Interactive Data's evaluated prices within the context of a broad range of relevant market information, including public and proprietary market data inputs used in the evaluated pricing process. This market context and insight helps clients address regulatory and accounting driven concerns about their valuation processes, and is already used by clients to support their FINRA Rule 5310 compliance activities. In particular, Vantage supports best execution compliance-related workflows through:
  - Analysis of actual trade data – Clients can examine the size of the trade, the side of the trade, the timing of the trade and the direction of the trade.
  - Additional market color – Vantage provides insight into quotes and other market data for the issue, enabling clients to compare this information against actual trade activity.
  - Comparable (similar) securities – Vantage identifies a range of comparable securities from the same issuer or securities from other issuers with similar characteristics, and provides clients the ability to drill down into the market activity for these issues.
  - Workflow – By combining these various components into a single display and enabling the creation of time-sensitive reports, clients can use Vantage to reduce manual efforts and streamline validation workflows.

## **2) “Securities with Limited Quotations or Pricing Information”:**

- We believe that provision six of the supplementary material is also valuable in that it appropriately highlights the fact that “markets for municipal securities may differ dramatically” and it is important that dealers be especially diligent when transacting securities for which there is limited pricing information or quotations available. In particular, we support the MSRB's assertion that dealers should “seek out other sources of pricing information” and “analyze other data to which it reasonably has access” in making its best-execution determinations.

- However, we believe that the MSRB should integrate the concept of similar securities into this provision. Furthermore, this provision currently leaves significant room for interpretation by dealers and enforcement examiners as to what may constitute other acceptable sources of pricing information or other data that may be analyzed in making best-execution determinations. More specifically, we recommend that the MSRB offer a non-exhaustive list of examples of what constitutes “other data” which might include recent trade activity, evaluated pricing and related, relevant market, assumptive and reference data.
  - We recommend expanding on the last sentence of this provision to reflect the aforementioned recommendations. A new sentence added to this section (highlighted in bold italics) could be: “Additionally, a dealer generally should, in determining whether the resultant price to the customer is as favorable as possible under prevailing market conditions, analyze other data to which it reasonably has access. ***Such data could include, but is not limited to, recent trade activity, independent third-party evaluated pricing, and related market, assumptive and reference data on the subject security or similar securities.***”

## Summary

Interactive Data appreciates the opportunity to comment on proposed draft MSRB Rule G-18. To help achieve the MSRB’s objectives and address important dealer concerns, we believe that the industry would benefit from greater clarity about the types of data that can be used to support best execution compliance activities. In particular, we believe that evaluated pricing from independent sources should be an important tool for dealers to consider in achieving best execution. Accordingly, we encourage the MSRB to modify its proposed rule to more explicitly reflect the value and utility of evaluated pricing in validating best execution. We believe that third-party valuation service providers like Interactive Data will continue to play an important role in helping participants in the municipal securities market value securities, and comply with a wide range of regulatory requirements. We look forward to working with the MSRB and the dealer community on this important issue.

Sincerely,



Andrew Hausman  
President, Interactive Data Pricing and Reference Data  
Interactive Data Corporation



## National Association of Independent Public Finance Advisors

P.O. Box 304

Montgomery, Illinois 60538.0304

630.896.1292 • 209.633.6265 Fax

[www.naipfa.com](http://www.naipfa.com)

March 21, 2014

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

Re: MSRB Notice 2014-02

The National Association of Independent Public Finance Advisors (“NAIPFA”) appreciates this opportunity to provide comments in connection with Municipal Securities Rulemaking Board (“MSRB”) Notice 2014-02 –Request for Comment on Draft Best-Execution Rule, Including Exception for Transactions with Sophisticated Municipal Market Professionals (the “Notice”).

### **Introduction**

In general, NAIPFA not opposed to the imposition of a best execution standard; provided, however, that any such standard will not negatively impact issuers of municipal securities (each an “Issuer”), and their tax and rate payers. As such, these comments are designed to express our concerns and raise questions relating to proposed rule G-18 (the “Proposed Rule”) with respect to its potential impact on Issuers, and their rate and tax payers.

### **Comments**

#### **1. Use of the term “Customer” Should be Clarified**

For purposes of the Proposed Rule, it is unclear who the MSRB is referring to when it uses the term “customer.” The term is not defined in the Proposed Rule nor in the MSRB Glossary. The closest definition to “customer” that appears in the MSRB Glossary is “customer trade,” which is defined broadly as essentially any trade in municipal securities involving a broker-dealer and a non-broker-dealer. Based on this definition, and because neither the Notice nor the Proposed Rule limit their use of the term “customer” solely to investors, an Issuer could arguably be considered a customer for purposes of the Proposed Rule. If this is the case, it is difficult to imagine how the Proposed Rule would be applied with respect to an underwriter’s purchase of securities from an Issuer. For example, would a broker-dealer have to utilize best execution procedures in connection with its purchase of securities from the Issuer in an initial public offering?

Despite the potentially broad nature of the term “customer,” there are indications within the Notice as well as MSRB Notice 2013-16, which suggest that the Proposed Rule is intended to be applicable only to investors. For instance, the Notice indicates that the “Stakeholders” include

“Investors,” but does not reference Issuers. Similarly, MSRB Notice 2013-16 makes several references to investors, stating in particular that the request for comment in connection therewith was “intended to elicit input from all interested parties . . . to more fully appreciate the benefits and impact of this requirement on investors and dealers.” In addition, no reference is made to Issuers in MSRB Notice 2013-16. Presumably, the MSRB would have noted Issuers in both notices if the Proposed Rule were intended to have a direct impact on them.

In light of the foregoing, NAIPFA is inclined to believe that the Proposed Rule is only intended to relate to the sale and purchase of municipal securities between a broker-dealer and an investor, and is not intended to establish rules relating to the purchase of securities from an Issuer. However, NAIPFA requests that the MSRB clarify his point, and to the extent that the Proposed Rule is intended to encompass an underwriter’s purchase of securities from an Issuer, NAIPFA requests that the Proposed Rule be re-proposed for comment prior to its submission to the SEC.

Notwithstanding this issue, we assume for the purposes of the comments below that the Notice and Proposed Rule’s use of the term “customer” is intended solely to refer to trades between investors and broker-dealers.

## 2. Fair Pricing Standard vs. Most Favorable Pricing Standard

NAIPFA disagrees with the Notice’s assessment of whether the Proposed Rule sets substantive pricing standards. Paragraph .01 of the Supplementary Materials of the Notice states:

The principal purpose of this rule is to promote, for customer transactions, dealers’ use of reasonable diligence in ascertaining the best market and obtaining the *most favorable price possible* under prevailing market conditions. A failure to have actually obtained the most favorable price will not necessarily mean that the dealer failed to use reasonable diligence.

Contrary to the Notice’s narrative portion, the above-referenced paragraph and the Proposed Rule create a substantive pricing standard. The first sentence obligates underwriters to undertake efforts to provide Issuers with the “most favorable price possible.” Whereas, the second sentence merely indicates that an underwriter’s failure to meet this substantive pricing standard will be a factor in determining whether the broker-dealer used reasonable due diligence. When viewed in conjunction with current Rules G-18 and G-30, these substantive pricing aspects become particularly evident.

In this regard, the Proposed Rule sets a substantive pricing expectation, that is, broker-dealers must strive to obtain the best price possible, whereas G-18 and G-30 establish substantive pricing floors, that is, prices given must be at least fair and reasonable. Thus, NAIPFA believes that the Proposed Rule, Paragraph .01, and current Rules G-18 and G-30 make clear that broker-dealers wishing to avoid MSRB rules violations must either (a) obtain the most favorable price, or (b) in the event that the most favorable price is not obtained, show that reasonable diligence was utilized in attempting to obtain the most favorable price and that the price ultimately obtained was nevertheless fair and reasonable.



However, regardless of whether the Proposed Rule establishes a substantive pricing standard, as discussed below, the Proposed Rule has implications with respect to the broker-dealer disclosures under MSRB Rule G-17 and may have significant negative impacts on the interests of Issuers, neither of which are addressed by the Notice.

### 3. Conflict with G-17

NAIPFA notes that the Notice does not make a distinction between transactions that occur during a primary/new offering of securities and those occurring in the secondary market. If, in fact, a broker-dealer will be obligated to undertake efforts to provide its customers with the most favorable prices within the context of a primary/new offering of securities, this will create an inconsistency in terms of a broker-dealer's obligations to Issuers and investors under Rule G-17.

As part of Rule G-17's interpretive guidance adopted by the MSRB in 2012, the MSRB mandated that broker-dealers serving as underwriters provide disclosures to Issuers stating, among other things, that

the underwriter has a duty to purchase securities from the issuer at a fair and reasonable price, but must balance that duty with its duty to sell municipal securities to investors at prices that are fair and reasonable.

This will no longer be true if the Proposed Rule is enacted, since broker-dealers will be obligated to attempt to sell municipal securities to investors at prices that are the most favorable to such investors. As such, the above referenced G-17 disclosure must be amended, otherwise Issuers will be misled with regard to their understanding of a broker-dealer's competing interests and the obligations owed by the underwriter to the various parties to the transaction.

Therefore, we respectfully request that broker-dealers acting as underwriters be obligated under G-17 to provide a disclosure to Issuers that accurately reflects the obligations imposed under the Proposed Rule. In this regard, the G-17 interpretive guidance should be revised to state something similar to the following:

the underwriter has a duty to purchase securities from the issuer at a fair and reasonable price, but must balance that duty with its duty to utilize reasonable due diligence to sell municipal securities to investors at prices that are the most favorable to such investors.

Currently, broker-dealers have to balance the competing, although equal, interests of Issuers and investors. However, the Proposed Rule will force underwriters to shift their pricing in favor of the interests of investors in a manner that will be contrary to the interests of Issuers. In other words, because broker-dealers will now be obligated to take steps to ensure that investors receive the most favorable prices, broker-dealers will be forced to offer less favorable prices, although still fair and reasonable, to Issuers. Thus, the Proposed Rule will potentially have a significant negative impact on Issuers, and their tax and rate payers.



Therefore, NAIPFA recommends that the MSRB limit the Proposed Rule to secondary market transactions in order to avoid the negative effects that the Proposed Rule is likely to have on Issuers and their constituents.

In the alternative, the MSRB must ensure that current MSRB Rules G-17, G-18 and G-30 do not conflict with the Proposed Rule. Further, to the extent that the Proposed Rule does conflict with any such rule, either the Proposed Rule or the conflicting rule must be amended to remedy any such inconsistency. Of particular concern in this regard is the apparent conflict between the Proposed Rule and the G-17 disclosure discussed above. Therefore, NAIPFA suggests that the G-17 disclosure be revised and harmonized with the new obligations imposed by the Proposed Rule.

### **Conclusion**

As noted above, NAIPFA is in general not opposed to a best execution rule. However, we request clarity as to the meaning of the term “customer” for purposes of the Proposed Rule. Further, we believe that the Proposed Rule does establish a substantive pricing standard, although failure to meet that standard will not in and of itself be determinative of whether a violation occurs. Notwithstanding this, the Proposed Rule should be limited solely to transactions between investors and broker-dealers occurring in the secondary market, since the application of the Proposed Rule to initial offerings of securities may have a significant negative impact upon municipal issuers.

Sincerely,



Jeanine Rodgers Caruso, CIPFA  
President, National Association of Independent Public Finance Advisors

cc: The Honorable Mary Jo White, Chairman  
The Honorable Kara Stein, Commissioner  
The Honorable Luis A. Aguilar, Commissioner  
The Honorable Michael Piwowar, Commissioner  
The Honorable Daniel M. Gallagher, Commissioner  
Lynnette Kelly, Executive Director, Municipal Securities Rulemaking Board





March 31, 2014  
Mr. Ronald W. Smith  
Corporate Secretary, MSRB  
1900 Duke Street, Suite 600  
Alexandria, VA 22314

**Re: MSRB Notice 2014-02 February 19, 2014 – Request for Comment on  
Draft Best-Execution Rule, Including Exception for Transactions with  
Sophisticated Municipal Market Professionals**

Dear Mr. Smith:

NYSE Euronext (the “Exchange”) appreciates the opportunity to comment on the Municipal Securities Rulemaking Board’s (“MSRB”) Request for Comment on Draft Best Execution Rule, Including Exception for Transactions with Sophisticated Municipal Market Professionals (the “Proposal”).<sup>1</sup> Although the Exchange believes additional changes to the rule would further strengthen its impact, enacting the Proposal would help create a more transparent and fair market for all investors, particularly retail investors.

### Best Execution

The stated objective of the Proposal is “to use the best-execution standard to promote higher quality trade executions for customers engaging in municipal securities transactions.” The Proposal seeks to attain its goals by harmonizing execution standards in the municipal securities market with those of other securities markets, including corporate bonds, while accommodating real differences in market structure between the MMS securities and municipal securities.

The Proposal correctly requires dealers to use reasonable diligence in satisfying their obligation to obtain the most favorable price for their customers under prevailing market conditions and sets forth a non-exhaustive list of factors that dealers would have to consider in satisfying its diligence obligations. For example, one factor would take into account the number of markets a dealer checked, as well as how the dealer determined the current market for the subject securities. The Proposal goes on to state that the term “market” encompasses a variety of venues including alternative trading systems and platforms.

As mentioned, the standards in the Proposal are largely taken from existing FINRA rules governing trading in other securities, including corporate bonds. The Exchange notes that although these same best execution obligations apply to dealers in corporate bonds, the Exchange consistently observes corporate bond trades on FINRA TRACE reported at prices inferior to

<sup>1</sup> MSRB Notice 2014-02 (February 19, 2014) <http://msrb.org/~media/Files/Regulatory-Notices/RFCs/2014-02.aspx?n=1>



quotes available on the Exchange's bond trading platform.<sup>2</sup> For this reason, the Exchange believes that the Proposal's objective to promote higher quality trade executions for customers engaging in municipal securities transactions would be furthered by clarifying that a dealer has NOT satisfied its best execution obligation if it ignores a superior price available on another "market" that offers fair access, transparent pricing and offers firm electronic quotes.

### **Increased Price Transparency**

The fragmented view of dealer inventory and limited distribution of "bids wanted" price information contribute to the opacity of the municipal securities market. The Exchange believes that the creation of a consolidated feed of these data would be an extremely powerful information tool for customers engaging in municipal securities transactions. The Exchange appreciates the MSRB's efforts to address some of these issues through the 2013 Concept Release on Pre-Trade and Post-Trade Pricing Data Dissemination Through a New Central Transparency Platform<sup>3</sup> and the Securities and Exchange Commission's 2012 Report on the Municipal Securities Market, which made similar recommendations.<sup>4</sup> A consolidated feed would increase market transparency, facilitate retail investors' ability to make informed investment decisions, enhance a broker's best execution process, and improve regulator's surveillance of the market. Accordingly, we believe that for investors to fully realize the benefits of a best execution rule, the MSRB should propose a rule that will advance the efforts of pre-trade transparency.

\* \* \* \* \*

The Exchange appreciates the opportunity to comment on the Proposal. We believe this Proposal can help to foster a more fair, open, and transparent investment environment.

Please contact Sudhir Bhattacharya at (212) 656-2920 or Kevin Molloy at (212) 656-6918 if you have any questions.

Sincerely,



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<sup>2</sup> The Exchange currently supports trading for corporate bonds of companies listed on NYSE. The platform offers fair access, full price transparency, and truly live executable quotes.  
<sup>3</sup> Municipal Securities Rulemaking Board, Long-Range Plan for Market Transparency Products, January 27, 2012, <http://www.msrb.org/msrb1/pdfs/Long-Range-Plan.pdf>  
<sup>4</sup> Securities and Exchange Commission, [Report on the Municipal Securities Market](#), July 31, 2012

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

Dear Mr. Smith,

Regional Brokers, Inc. (RBI) welcomes this opportunity to comment on changes to MSRB rule G-18.

RBI is a Municipal Securities Broker's Broker (MSBB) located in Philadelphia, Pa. RBI acts as a Broker's Broker, trading only with FINRA member firms. RBI provides bid wanted auctions and negotiates trades between its counterparties in an undisclosed manner. RBI has no "customers" in the definition of FINRA.

RBI's comments contain two parts; one that addresses how the Rule could impact RBI's business model directly, and one that addresses how the Rule could impact RBI's business model indirectly.

#### Part One- Direct Impact on MSBBs

The MSRB, in its "Summary of Draft Rule G-18 and Draft Amendments to Proposed Rule G-48" states the following- "Consistent with this current policy, and in light of the role of broker's brokers in the municipal securities market in providing liquidity, paragraph (b) does not prohibit the use of a broker's broker, unless it would be inconsistent with the best execution obligation in paragraph (a)."

RBI would comment that it hopes that the MSRB will continue to make the above statement clear to all market participants; that the new rule regarding Best Execution does NOT prohibit the use of Municipal Securities Broker's Brokers (MSSBs) unless it proved detrimental to the price received by the customer.

RBI believes that it and other MSBBs can play an important role in the market by providing increased liquidity and advantageous pricing for buyers and sellers of municipal bonds, thereby increasing the chance of best execution for the dealer's customer.

RBI also understands its obligation to step out of any trade that might interfere with the ability of the customer to receive best execution, and is perfectly willing to do so.

#### Part Two- Indirect Impact on MSBBs

The municipal market is a negotiated, subjective market, where prices of bonds are developed based upon many factors, including supply and demand, interest rate fluctuations, credit-worthiness of an issue, and cost of carry. Traders make

assumptions about these and other factors as they decide what price they should pay for a bond in order to be able to sell it at a profit. Unlike the stock market, where the trades of securities are instantly matched between buyers and sellers, traders in the municipal market must often be willing to take bonds into their inventories and carry them for days or weeks.

The fact that assumptions play a role in the pricing of municipal bonds means, inherently, that there can be no exact price at which a bond should trade on any given day.

RBI's business model is based on the willingness of traders to place bids on auctions run by RBI, with the intent of buying bonds and selling them at a profit either to their customers or to other dealers. RBI believes that an attempt to hold traders to a strict "best execution" rule would have a chilling effect on the willingness of some traders to place bids on these items, in a market that already faces liquidity problems. The Rule could damage the market for those same participants that the MSRB is trying to protect- the individual bondholders that make up such a great percentage of the marketplace.

Perhaps the following story, which I related to a SIFMA roundtable that I recently attended, will give an example of the sort of illiquidity that we are facing.

RBI had a 10m odd lot for the bid. As always, we contacted all the potential bidders we could, including one trader to whom RBI had sold a matching piece of 100m the previous day, at 98. When asked for a bid, the trader replied that he could not bid the item. We reminded him that he had purchased the 100m on the previous day at 98. His reply was, "Yes, and I put those bonds away, as 100m, at 98.25. But I cannot sell a 10m piece at the same price I sold a 100m bond piece. And, if I buy them at the price I would need to in order to be able to resell them, I am afraid that a regulator will challenge me on the trade, telling me that I have paid too little for the bonds, because they will use yesterday's trade at 98 as a benchmark for where a bond should trade. So, I am no bid for the bonds."

RBI ended up trading the bonds to a bidder that was an even lower bid than the original buyer might have been- the second buyer had no recent purchases of the bond to make that trader feel as vulnerable to scrutiny. The bid was within the parameters that RBI had established for a "fair and reasonable" price on the bonds, but it was still discouraging not to be able to provide the better bid that we believed we might have been able to achieve for bonds that were being sold, obviously, from a retail account.

The implementation of a "best execution" rule could exacerbate this already difficult situation. Traders who, despite being the best potential bidder on bonds in the market on a particular day, will be even more leery of exposing themselves to regulatory scrutiny when they fear that regulators might argue that there is only one exact price that should be paid for a bond. Furthermore, traders will not have

the advantage of “hindsight” that a regulator might use when looking back at trades done weeks or months in the past.

Currently, the market uses “fair and reasonable” to gauge whether a trade has been properly executed. When a “best execution” rule is put into effect, what guideline will the MSRB use to gauge the proper price paid for a bond- other than prices that are reported through EMMA? But, which prices on EMMA are correct? The comparisons that are used do not take into account the many intrinsic reasons that bonds may trade at various prices, including size of the block, market fluctuation, and supply and demand. If a trade is done in the morning at 86, and another later in the day at 90, which one was correct? Were they both correct? What is the basis for challenging the price of either trade? At this time, the MSRB is unable to truly identify the correct price. Until there is enough price transparency to see large samples of the prices at which a bond trades, there can be no measure of the absolute, and therefore, best execution, price. And, given the fact that some bonds trade only once or twice a year, or less, it would seem that the volume of information may never become available. Therefore, as the SEC recommended in its SEC Report, RBI would request guidance from the MSRB to assist dealers in demonstrating compliance with any new best execution requirements, and clarity to its enforcement regulators.

Thank you again for giving us the opportunity to comment on this proposed Rule, and RBI looks forward to a continuing dialogue regarding how to achieve the goals of the MSRB regarding the prices at which municipal bonds trade.

Sincerely,

H. Deane Armstrong  
CCO  
Regional Brokers, Inc.



March 13, 2014

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

Re: **MSRB Notice 2014-02 (February 19, 2014) Request for Comment on Draft Best Execution Rule, Including Exception for Transactions with Sophisticated Municipal Market Professionals**

Dear Mr. Smith:

The Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> appreciates the opportunity to comment on the Municipal Securities Rulemaking Board’s (“MSRB”) Request for Comment on Draft Best Execution Rule, Including Exception for Transactions with Sophisticated Municipal Market Professionals<sup>2</sup> (the “Proposal”). SIFMA also appreciates the MSRB’s consideration of our ‘execution with diligence’ proposal<sup>3</sup>. We and our members share the 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 for the past year. 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.

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<sup>1</sup> 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).

<sup>2</sup> MSRB Notice 2014-02 (February 19, 2014) available at <http://msrb.org/~media/Files/Regulatory-Notices/RFCs/2014-02.ashx?n=1>

<sup>3</sup> 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>

## **I. Executive Summary**

SIFMA believes 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 markets. It also complements a dealer's pricing obligation under Rule G-30. Before the MSRB adopts a final rule, SIFMA requests additional information and guidance from the MSRB relating to the harmonization of Rule G-18 and G-30, as well as compliance issues. Additionally, the MSRB should separately issue a request for data and other information, in particular quantitative data, relating to the benefits and costs that could result from various alternative approaches regarding the standards of conduct and other obligations relating to its Proposal.

## **II. Background**

Soon after the U.S. Securities and Exchange Commission issued a Report on the Municipal Securities Market in July 2012<sup>4</sup> (the "SEC Report" or "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 20 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 effort. The MSRB's Proposal reflects numerous suggestions made by SIFMA.

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<sup>4</sup> 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>.

SIFMA respectfully disagrees with applying equity-based best execution standards to the municipal market. SIFMA strongly believes that rules and standards regarding execution must reflect their fundamental limitations and objects to rules that implicitly or explicitly import notions of best execution more appropriately applied to markets for more liquid equity and corporate debt securities. Any divergence from existing equity and corporate debt securities execution requirements should not be intended to dilute them, but to impose requirements that are properly tailored for the municipal market. SIFMA does not challenge the notion that the *goal* of a dealer's execution diligence is to provide the customer with the most favorable price. However, SIFMA believes 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 markets.<sup>5</sup> It also complements a dealer's pricing obligation under Rule G-30.

### III. Relationship between G-18 and G-30

For over thirty years, municipal securities dealers have followed the guidance published by the MSRB in its 1980 *Report on Pricing*<sup>6</sup> to provide direction in determining the fairness of prices that customers receive. The substance of this report has been reaffirmed<sup>7</sup> and built upon since then<sup>8</sup>. SIFMA concurs with the views repeated by the

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<sup>5</sup> The phrase "best execution" carries with it a clear meaning, which as SIFMA and MSRB have acknowledged is not the standard that MSRB is trying to adopt for the municipal securities market with this proposed rulemaking. Unfortunately, enforcement examiners, reporters, and others who are not intimately familiar with the MSRB's intent with this "best execution" standard will apply the plain meaning of this phrase and hold dealers to standards in enforcement actions, regulatory exams, and reporting that are inconsistent with the MSRB's intent. The best way to avoid that outcome is to discontinue using the "best execution" label in favor of a label that does not imply anything other than the reasonable diligence standard that the MSRB is proposing.

<sup>6</sup> MSRB *Report on Pricing* (September 26, 1980, republished on October 3, 1984) available at [http://msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-30.aspx?tab=2#\\_F9EBEC49-FAD0-4200-B016-A7002071FDF3](http://msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-30.aspx?tab=2#_F9EBEC49-FAD0-4200-B016-A7002071FDF3) (the "Report on Pricing").

<sup>7</sup> *Id.*

<sup>8</sup> Republication of the Report on Pricing (October 3, 1984), *supra* Note 3; Rule G-30 Interpretive Notice, *Review of Dealer Pricing Responsibilities* (January 26, 2004) (the "2004 Notice") available at [http://msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-30.aspx?tab=2#\\_A5756731-6EF3-45A9-BB32-0EACF2074FD8](http://msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-30.aspx?tab=2#_A5756731-6EF3-45A9-BB32-0EACF2074FD8); , *Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities* (July 14 2009) (the "2009 Notice"), available at <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2009/2009-42.aspx?n=1>; Restated Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals (July 9, 2012), available at [http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17.aspx?tab=2#\\_D37D3EF9-F642-4A63-A40D-3A6B33B5260A](http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17.aspx?tab=2#_D37D3EF9-F642-4A63-A40D-3A6B33B5260A) ; Interpretive Notice Concerning the Application of MSRB Rule G-17 to underwriters of Municipal Securities (August 2, 2012), available at <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-25.aspx>; see also MSRB Interpretation of November 29, 1993, *Factors in Pricing* (the "1993 Interpretation"), available at [http://msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-30.aspx?tab=3#\\_2499EFE4-BC98-490D-A145-70C9D62B91A6](http://msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-30.aspx?tab=3#_2499EFE4-BC98-490D-A145-70C9D62B91A6)

MSRB in its recent filing with the SEC<sup>9</sup> that Rule G-30's standards for fair and reasonable pricing should be preserved, as the rule appropriately balances investor-protection interests with the need for efficient municipal markets. This standard reflects the current market structure and unique attributes of the municipal securities market. Rule G-30's substantive pricing standards complement a dealer's order-handling and transaction-execution responsibilities. While they are separate obligations, they are necessarily linked. Yet the entirety of prior MSRB rule making and guidance regarding pricing is being consolidated into revised Rule G-30. Accordingly, SIFMA requests that the MSRB provide guidance on the interplay between G-18 and G-30, specifically the applicability of Rule G-30's "Relevant Factors in Determining the Fairness and Reasonableness of Prices" to proposed Rule G-18. Market participants must be given the opportunity to understand and comment on how these two rules will continue to work hand in hand, or not.

#### **IV. Demonstrating Compliance**

Some of SIFMA's members currently follow as a business practice the order handling process under FINRA 5310 for municipal securities. Accordingly, they are looking for guidance<sup>10</sup> from the MSRB as to how they would demonstrate "best execution" "reasonable diligence" compliance versus current fair dealing obligations, and what, if any, additional steps would need to be taken to adhere to the new standard as the scope of the duty and the methods of demonstrating satisfaction diverge substantially from the traditional methods of best execution for equity securities. This guidance would also be instructive to dealers that do not currently utilize such a robust order handling and post trade review of execution quality.

#### **V. Prevailing Market Conditions**

SIFMA members have shared with us anecdotally that they are often required in examinations to defend and justify the execution price of a customer trade against a higher or lower customer trade of the same CUSIP that took place *later* the same day, T+1, T+2, or even further out. This, alas, requires pre-cognition. Prevailing market conditions should be defined within G-18 as those conditions that are reasonably known to the market at the time of execution. Pricing of municipal bonds is inherently somewhat subjective. Absent guidance that assures the industry that the regulators understand and agree that the term "best execution" (as it relates to municipals) does not mean every trade at a particular point in time (within 24 to 48 hours) must match the best price to have occurred *thereafter*, the

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<sup>9</sup> SR-2014-01 (January 29, 2014), *Proposed Rule Change Consisting of Proposed Revisions to MSRB Rule G-30, on Prices and Commissions and the Deletion of Rule G-18, on Execution of Transactions*, available at <http://msrb.org/Rules-and-Interpretations/SEC-Filings/~//media/Files/SEC-Filings/2014/SR-MSRB-2014-01.ashx>

<sup>10</sup> As noted in Section II, above, the SEC Report recommends to the MSRB, in addition to rule making, that it provide more detailed *guidance* on how "best execution" concepts would be applied in connection with transactions in the municipal market.



result will be fewer and fewer firms willing to make markets and the further result will be much worse execution for investors over time.

Unlike the treasury or stock markets, there is not a quoted market for municipal securities. There is not a single "screen" to look at that *determines* the price and even if there were such a single point of overall market inspection, it would only represent what a particular dealer was willing to pay at a particular point in time. Factually, there are very rarely numerous buyers and sellers of a given municipal security over a short time span, which would (if they existed) allow market price convergence to occur and permit an equity-type best execution rule to be meaningful. Unfortunately, rules alone cannot create this behavior. Even if a single automated trading system were to dominate the market place, such behavior is not going to happen, because the MSRB cannot control the ordinary commercial decision-making of bond *owners* and there are too many individual municipal securities.

The MSRB 2013 Fact Book illustrates the problem nicely in its chart titled "Average Trading Volume by Day of Week, 2013"<sup>11</sup>. As is made clear by the data at the bottom of that page, on average, an individual municipal security trades less than 3 times per day. Since some securities (particularly new issue securities) do trade multiple times a day, the ordinary trade frequency of secondary market municipal securities is even lower.

## **VI. Economic Analysis**

SIFMA and its members believe that evaluating the costs and burdens of new regulation, and weighing those costs against any benefits derived from such new regulation, is critical to ensure efficient regulation. An essential component of this principle is conducting a true, reality-based, (and if possible dollar-specific) cost-benefit analysis of new rule proposals and other initiatives. Fully consider the costs and burdens to both the MSRB and its funders weighed against potential benefits, which we understand are much more difficult to value, as well as reasonable alternatives. SIFMA is pleased that the MSRB has adopted a formal framework for its approach to integrate economic analysis into its proposed rulemaking.<sup>12</sup>

SIFMA agrees with the MSRB's goal to improve the execution quality for customer transactions. And while the MSRB acknowledges concerns raised, in response to the MSRB's prior concept release on whether to adopt a best execution

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<sup>11</sup> MSRB 2013 Fact Book page 14, available at <http://www.msrb.org/msrb1/pdfs/MSRB-Fact-Book-2013.pdf>. Averages are derived from the data: Monday 2.66 trades/CUSIP; Tuesday 2.73 trades/CUSIP; Wednesday 2.75 trades/CUSIP/ Thursday 2.75 trades/CUSIP; Friday 2.67 trades/CUSIP. Of course, some securities traded far more often in a given day, and others only traded once.

<sup>12</sup> Policy on the Use of Economic Analysis in MSRB Rulemaking (September 26, 2013) available at <http://msrb.org/About-MSRB/Financial-and-Other-Information/Financial-Policies/Economic-Analysis-Policy.aspx>

rule<sup>13</sup>, that imposing a best execution standard on the municipal market would impose significant additional costs on dealers, which may result in some dealers discontinuing offering municipal securities to their retail customers negatively impacting liquidity in this market – yet the MSRB’s economic analysis in the Proposal does not reach any conclusions other than to say in essence that the data is not available. SIFMA believes that any new rulemaking should not hinder liquidity in the market. It is critical that the MSRB strike the appropriate balance between investor protection interests and the efficient operation of the municipal markets. SIFMA would be pleased to work with the MSRB to obtain reliable empirical data to assist it in quantifying such costs and benefits. As SIFMA has said in prior comment letters, such data cannot be obtained in the tight time frame of a Request for Comments deadline<sup>14</sup>. A data request could include: the costs of developing and maintaining a comprehensive compliance and supervisory system, procedures and training programs to implement the new standard, as well as updates when regulatory guidance is updated, or legal precedent and/or firm practices change. In terms of the costs components for developing, preparing, and maintaining such systems the following should be considered: (i) outside legal costs, (ii) outside compliance consultant costs, (iii) other out-of-pocket costs, and (iv) employee- and staff related costs. Expense categories that could comprise estimates of “out-of-pocket” costs could include: information technology and vendors, information technology systems, hardware and software, support and testing/audit; business review, risk review and surveillance.

Additionally, SIFMA believes that the proper baseline for comparing and evaluating the costs and benefits of the Proposal is current Rule G-18 as well as the reasonable alternative proposed by SIFMA in the form of its “execution with diligence proposal”.

## **VII. Proposed Exemption for Transactions with Sophisticated Municipal Market Professionals**

The Proposal contains an exemption from best execution for transactions with Sophisticated Municipal Market Professionals (“SMMPs”). SIFMA supports this exemption as it is consistent with the SEC Report’s focus on retail investors. It is also consistent with the treatment of SMMPs under existing MSRB rulemaking.

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<sup>13</sup> MSRB Notice 2013-06 (August 6, 2013) *Request for Comment on Whether to Require Dealers to Adopt a “Best Execution” Standard for Municipal Securities Transactions* available at <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-16.aspx?n=1>

<sup>14</sup> As a point of comparison, interested parties were given 120 days from publication in the Federal Register to comment on and respond to the Securities and Exchange Commission’s Request for Data and Other Information (Release No. 34-69013; IA-3558; File No. 4-606) available at <http://www.sec.gov/rules/other/2013/34-69013.pdf>

## **VIII. Implementation Period**

Any regulatory scheme takes time to implement properly. Implementing a best execution standard for the municipal market is revolutionary. Dealers will need a reasonable time to allow for a sufficient implementation period to develop, test, and implement compliance and supervisory policies and procedures, systems and controls, testing/auditing as well as extensive training. Therefore, SIFMA requests an implementation period, which would be no less than one year from approval by the SEC, before the Proposal becomes effective.

## **IX. Comments on Specific Language**

### **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 checked<sup>15</sup>”. 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 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. 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. Accordingly, we strongly disagree with any suggestion that the act of contacting other dealers would be the implicit or requisite procedure to evidence best execution.

### **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 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

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<sup>15</sup> 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?

execution. Uncertainty surrounding what constitutes “reasonable diligence” may result in reduced willingness to bid bonds or offer bonds to retail customers, which would harm liquidity in the municipal market. Consistent with the SEC’s recommendation in the SEC Report, SIFMA requests guidance from the MSRB to assist dealers in demonstrating compliance with any new best execution requirements and give clarity to enforcement regulators.

Supplementary Material .08 Review of Execution Quality requires a dealer to conduct periodic reviews of its policies and procedures for determining the best available market for the execution of its customer’s transactions. Execution quality relates to customer pricing and under the current market structure this would necessarily include a post-trade price review. Accordingly, we suggest adding “under which the goal is to provide the customer with a fair and reasonable price possible under prevailing market conditions”. Accordingly the complete first sentence of Section .08(a) would read: “A dealer must, at a minimum, conduct periodic reviews of its policies and procedures for determining the best available market for the executions of its customer’s transactions under which the goal is to provide the customer with a fair and reasonable price possible under prevailing market conditions.”

## **X. Conclusion**

SIFMA sincerely appreciates this opportunity to comment on the Proposal. SIFMA supports raising the execution standard in the municipal market in a way that reflects the current market structure and unique characteristics of the municipal market. We believe SIFMA’s “execution with diligence” proposal accomplishes this goal. Before the MSRB adopts a final rule SIFMA requests additional information and guidance from the MSRB. Additionally, the MSRB should separately issue a request for data and other information, in particular quantitative data, relating to the benefits and costs that could result from various alternative approaches regarding the standards of conduct and other obligations relating to its Proposal.

SIFMA looks forward to continuing its dialog with the MSRB on this important topic.

Please do not hesitate to contact me with any questions at (212) 313-1265.

Sincerely yours,

A handwritten signature in blue ink that reads "David L. Cohen". The signature is fluid and cursive, with the first name being the most prominent.

David L. Cohen  
Managing Director  
Associate General Counsel

Mr. Ronald W. Smith  
Municipal Securities Rulemaking Board  
Page 9 of 9

cc:

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



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Member FINRA/SIPC

April 2, 2014

**Via E-mail to <http://www.msrb.org/CommentForm.aspx>**

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

**RE: MSRB Notice 2014-02 Request for Comment on Draft Best-Execution Rule,  
Including Exception for Transactions with Sophisticated Municipal Market  
Professionals**

Dear Mr. Smith:

Wells Fargo Advisors, LLC (“WFA”) appreciates the opportunity to comment on the Municipal Securities Rulemaking Board’s (“MSRB” or “the Board”) draft best execution rule. WFA commends the Board’s effort to tailor a best execution rule to the nature of the municipal market and to “target the process by which dealers handle orders and execute transactions.”<sup>1</sup>

WFA consists of brokerage operations that administer almost \$1.4 trillion in client assets. It employs approximately 15,280 full-service financial advisors in branch offices in all 50 states and 3,328 licensed financial specialists in retail stores across the United States.<sup>2</sup> WFA offers a range of fixed income solutions to its clients, many of whom regularly transact in municipal securities in the secondary markets.

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<sup>1</sup> MSRB Regulatory Notice 2014-02 Request for Comment on Draft Best-Execution Rule, Including Exception for Transactions with Sophisticated Municipal Market Professionals at 5, <http://msrb.org/~media/Files/Regulatory-Notices/RFCs/2014-02.ashx?n=1>.

<sup>2</sup> WFA is a non-bank affiliate of Wells Fargo & Company (“Wells Fargo”), a diversified financial services company providing banking, insurance, investments, mortgage, and consumer and commercial finance across the United States of America and internationally. Wells Fargo has 264,000 team members across more than 80 businesses. Wells Fargo’s brokerage affiliates also include Wells Fargo Advisors Financial Network, LLC (“WFAFN”) and First Clearing, LLC, which provides clearing services to 78 correspondent clients, WFA and WFAFN. For the ease of discussion, this letter will use WFA to refer to all of those brokerage operations.

WFA previously commented to express its view that existing fair pricing standards were better situated to municipal market conditions than a best execution requirement based upon FINRA's equity-oriented best execution rule.<sup>3</sup> Notwithstanding its prior stated position, WFA appreciates the MSRB's effort to "tailor the draft rule to the municipal securities market."<sup>4</sup> In particular, WFA applauds the MSRB's recognition that a regular and rigorous review requirement similar to that in FINRA Supplementary Material 5310.09 is not suited to municipal market conditions. WFA submits these comments to encourage the Board to provide further clarification about how a best execution standard would apply to municipal securities.

**Provide guidance to clarify when a firm has exercised reasonable diligence.**

Proposed Rule G-18 outlines factors that will be considered to determine whether a dealer exercised reasonable diligence in pursuit of the most favorable price possible under prevailing market conditions.<sup>5</sup> Proposed Supplementary Material .01 explains that the rule's "principal purpose" is the promotion of "reasonable diligence in ascertaining the best market and obtaining the most favorable price possible under prevailing market conditions."<sup>6</sup> It also notes that a failure to achieve the most favorable price may not mean that reasonable diligence has not been exercised. Nevertheless, there is little guidance in the Proposed Rule and Supplementary Material to elaborate how reasonable diligence can be demonstrated.<sup>7</sup> Furthermore, the Proposed Rule does not delineate how diligence obligations may differ when effecting customer purchases versus customer sales of municipal securities.

Proposed Supplementary Material .04 includes broker's brokers and alternative trading systems ("ATS") within its list of venues that may be considered part of the market for a municipal security. In addition, the material notes the MSRB is not "mandating that certain trading venues have less relevance than others" and the term market should be "construed broadly."<sup>8</sup> Accordingly, MSRB should provide clarity regarding the circumstances when firms must check such venues to satisfy diligence obligations in pursuit of the best market. For example, if a security is actively traded and interest rates and credit rates are stable, could a dealer meet its diligence obligations by pricing its trade based on recent trade history in that security, or is it the MSRB's expectation that, even for actively traded bonds in a stable market, a dealer must consult one or more broker's brokers or alternative trading systems to show diligence?

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<sup>3</sup> Robert J. McCarthy letter responding to MSRB Notice 2013-16 Request for Comment on Whether to Require Dealers to Adopt a "Best Execution" Standard for Municipal Securities Transactions, <http://msrb.org/RFC/2013-16/wellsfargo.pdf>.

<sup>4</sup> Notice 2014-02 at 6.

<sup>5</sup> *Id.* at 17.

<sup>6</sup> *Id.* at 18.

<sup>7</sup> *See id.* at 19, outlining in Proposed Supplementary Material .06, some guidance in relation to securities with limited quotations or pricing information.

<sup>8</sup> *Id.* at 18.

Proposed Supplementary Material .06 notes that “a dealer must be especially diligent” to meet its best execution responsibilities when limited pricing information or quotations are available.<sup>9</sup> It instructs dealers to have written policies and procedures outlining how the dealer will meet its best execution duties in such a circumstance. However, the Supplementary Material provides no guidance about what it means to have “limited pricing information or quotations available.” For example, does the fact that no quotes are currently available mean that a bond has limited pricing or quotation information available? What if there is no quote but other sources of information such as comparable security executions are available? What if a quote is available but the bond has not traded in the last 30 days? The MSRB should offer additional guidance to elaborate how a dealer would identify that a bond has limited pricing or quotations available.

In addition, Proposed Supplementary Material .06 indicates that a dealer should “seek out other sources of pricing information and potential liquidity” for securities with limited pricing information or quotations. It is not clear however what these “other sources” would be. Could a dealer satisfy its diligence obligations for such a security by pricing it to yield equivalency with a comparable security? Could a dealer rely on vendor pricing data? Conversely, must a dealer always take such steps as conducting a bid wanted inquiry or consulting broker’s brokers when there is limited pricing information or quotations for a security? The MSRB should clarify what is meant by “other sources” and outline circumstances in which the use of a particular source is sufficient to support reasonable diligence.

Proposed Supplementary Material .06 also states “a dealer generally should seek out other sources of pricing information and potential liquidity for such a security, including other dealers that the dealer previously has traded with in the security.” WFA is concerned this language is overly broad and could unintentionally impose an obligation for firms to contact all dealers with which it has previously traded in a specific security in connection with customer orders in illiquid securities.

Proposed Supplementary Material .02 notes that a “dealer’s failure to maintain adequate resources” such as staff or technology does not justify an execution “away from the best available market.”<sup>10</sup> Although, the Supplementary Material acknowledges that a dealer’s business and level of activity are factors in determining the appropriate resource level, it does not offer guidance to clarify what it considers “adequate resources” other than by broadly referencing staff and technology.<sup>11</sup> The MSRB should offer more clarity about how a firm establishes that it has the appropriate level of resources. For example, must an active dealer subscribe to some or all ATS to demonstrate that it has adequate resources? If a dealer does not subscribe to a particular ATS and executes at a price inferior to that available on that ATS, will it be presumed to have failed to exercise adequate diligence?

Proposed Supplementary Material .03 explains that dealers must “make every effort to execute a customer transaction in a reasonably timely manner” but also notes that “[i]n certain market conditions a dealer may need to use more time to use reasonable diligence” in order to

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<sup>9</sup> *Id.* at 19.

<sup>10</sup> *Id.* at 18.

<sup>11</sup> *Id.*



Ronald W. Smith

April 2, 2014

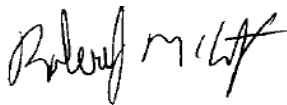
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determine the best market.<sup>12</sup> The Supplementary Material, however, does not offer examples of circumstances where reasonable diligence requires more time. Does this apply only in the case of a security with limited pricing information or quotations available? If quotes are available from more than one ATS are market conditions such that a dealer should prioritize timeliness of execution? The MSRB should provide additional guidance to illustrate how dealers can identify trades that require more time to show reasonable diligence.

## CONCLUSION

WFA appreciates the opportunity to share its views about the proposed municipal best execution rule and commends the MSRB for its efforts to tailor the rule to the unique character of the municipal securities market. As described in the foregoing comments, WFA believes the MSRB should provide additional guidance about the steps needed to evidence reasonable diligence.

Sincerely,



Robert J. McCarthy  
Director of Regulatory Policy

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<sup>12</sup> *Id.*

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March 21, 2014

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

Dear Mr. Smith:

Thank you for the opportunity to comment on Regulatory Notice 2014-02. Wulff, Hansen & Co. is a registered broker/dealer active in the California municipal market.

Most of our thoughts on the draft best execution rule are well expressed in the SIFMA comment letter of March 13, 2014 and we will not repeat all of SIFMA's points here.

We agree that customers should pay a fair and reasonable price. However, the concept of 'best execution' as applied to more liquid markets in which individual securities are widely known and trade frequently is an inappropriate standard for the municipal market. There is simply not enough price information available for a traditional best execution standard to be workable. This lack of price information is inherent in the nature of the market itself and is not something which can be changed by making rules unless the rules were to require that market participants constantly publish numerous bids and offers against their will.

An attempt to apply the best execution standard used in more liquid markets will almost certainly make the municipal market even less liquid than it is today by increasing the perceived regulatory risk to a dealer of making a particular trade.

We particularly agree with SIFMA's comments on G-18(a) with regard to checking markets. They are correct in asserting that in some cases the very act of making an inquiry about a particular security can change the market for that security.

We also strongly support their view of the need to ensure that regulators cease the preposterous use of hindsight in evaluating execution prices, whereby trades occurring later in time than the one being evaluated are used as a standard by which to judge the earlier execution. 'Prevailing market conditions' must refer to a period ending at the moment of execution.

Thank you again for the opportunity to comment.

Very truly yours,

Chris Charles  
President