

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-67238; File No. SR-MSRB-2012-04)

June 22, 2012

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1, Relating to 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

I. Introduction

On March 5, 2012, the Municipal Securities Rulemaking Board ("MSRB") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change consisting of proposed MSRB Rule G-43, on broker's brokers; amendments to MSRB Rule G-8, on books and records; amendments to MSRB Rule G-9, on record retention; amendments to MSRB Rule G-18, on execution of transactions; and a proposed interpretive notice on duties of dealers that use the services of broker's brokers ("Proposed Notice"). The proposed rule change was published for comment in the Federal Register on March 26, 2012.<sup>3</sup> The Commission received six comment letters regarding the proposal.<sup>4</sup> On May 3, 2012, the MSRB

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 66625 (March 20, 2012), 77 FR 17548 ("Notice").

<sup>4</sup> See Letters to Elizabeth M. Murphy, Secretary, Commission, from John Webber, Chief Compliance Officer, Advisors Asset Management, Inc., dated April 16, 2012 ("AAM Letter"); Michael Nicholas, Chief Executive Officer, Bond Dealers of America, dated April 16, 2012 ("BDA Letter"); Thomas S. Vales, Chief Executive Officer, TMC Bonds, LLC, received April 16, 2012 ("TMC Letter"); Mark J. Epstein, President & Chief Executive Officer, Hartfield, Titus & Donnelly, dated April 18, 2012 ("HTD Letter"); Paige W. Pierce, President & Chief Executive Officer, RW Smith & Associates, Inc., received April 19, 2012 ("RWS Letter"); and August J. Hoerrner, Senior Managing Director, Chapdelaine Tullett Prebon, LLC, dated May 16, 2012 ("CTP Letter"). The

submitted a response to the comment letters<sup>5</sup> and filed Amendment No. 1 to the proposed rule change.<sup>6</sup> On May 9, 2012, the Commission designated a longer period to act on the proposed rule change, until June 22, 2012.<sup>7</sup> This order grants approval of the proposed rule change, as modified by Amendment No. 1 thereto.

## II. Description of the Proposed Rule Change

Broker's brokers, who act as intermediaries between selling dealers and bidding dealers, serve an important function in providing liquidity for investors in the municipal securities market. Broker's brokers are subject to general standards, such as MSRB Rules G-17 and G-18, concerning their conduct in the municipal securities market. MSRB Rule G-17 requires broker's brokers to deal fairly and not engage in any "deceptive, dishonest, or unfair practice."<sup>8</sup> MSRB Rule G-18 requires that they make reasonable efforts to obtain a fair and reasonable price in relation to prevailing market conditions.<sup>9</sup>

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comment letters received by the Commission are available at <http://www.sec.gov/comments/sr-msrb-2012-04/msrb201204.shtml>.

<sup>5</sup> See Letter to Elizabeth M. Murphy, Secretary, Commission, from Margaret C. Henry, General Counsel, Market Regulation, MSRB, dated May 3, 2012 ("MSRB Response").

<sup>6</sup> Amendment No. 1 would partially amend the text of the original proposed rule change to clarify that (i) MSRB Rule G-43(c)(i)(N) would only prohibit a broker's broker from accepting a new bid or a changed bid from a bidder in a bid-wanted after the broker's broker has notified that same bidder whether its bid was the high bid (*i.e.*, "being used") in the same bid-wanted; and (ii) a municipal security would be considered "traded" through a broker's broker within the meaning of MSRB Rule G-43(d)(iv) when it has been purchased by the broker's broker from the seller and sold to the bidder by the broker's broker, as an intermediary. Because the changes made in Amendment No. 1 do not materially alter the substance of the proposed rule change or raise any novel regulatory issues, Amendment No. 1 is not subject to notice and comment.

<sup>7</sup> Securities Exchange Act Release No. 66954, 77 FR 28653 (May 15, 2012).

<sup>8</sup> See MSRB Rule G-17.

<sup>9</sup> See MSRB Rule G-18.

Despite these general standards of care, concerns have arisen regarding the conduct of broker's brokers. Recent Commission and Financial Industry Regulatory Authority ("FINRA") enforcement actions have highlighted misconduct in the broker's broker industry with respect to their municipal securities activities.<sup>10</sup> This has raised concerns about the integrity of broker's brokers bid-wanted and offering processes.

As a result, the MSRB has proposed additional, detailed rules and interpretive guidance that apply to the conduct of broker's brokers and other brokers, dealers, and municipal securities dealers (collectively "dealers") in the municipal securities market. Specifically, the MSRB proposes new MSRB Rule G-43; to amend MSRB Rules G-8, G-9, and G-18; and to issue

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<sup>10</sup> See Notice, 77 FR at 17549 n.4. See also FINRA v. Associated Bond Brokers, Inc. Letter of Acceptance, Waiver and Consent No. E052004018001 (November 19, 2007) (settlement in connection with alleged violation of MSRB Rule G-17 by broker's broker due to lowering the highest bids to prices closer to the cover bids without informing either bidders or sellers); FINRA v. Butler Muni, LLC Letter of Acceptance, Waiver and Consent No. 2006007537201 (May 28, 2010) (settlement in connection with alleged violation of MSRB Rule G-17 by broker's broker due to failure to inform the seller of higher bids submitted by the highest bidders); D. M. Keck & Company, Inc. d/b/a Discount Munibrokers, et al., Securities Exchange Act Release No. 56543 (September 27, 2007) (settlement in connection with alleged violation of MSRB Rules G-13 and G-17 by broker's broker for dissemination of fake cover bids to both seller and winning bidder; also settlement in connection with alleged violation of MSRB Rules G-14 and G-17 by broker's broker due to payment to seller of more than highest bid on some trades in return for a price lower than the highest bid on other trades, in each case reporting the fictitious trade prices to the MSRB's Real-Time Trade Reporting System); Regional Brokers, Inc. et al., Securities Exchange Act Release No. 56542 (September 27, 2007) (settlement in connection with alleged violation of Rules G-13 and G-17 by broker's broker for dissemination of fake cover bids to both seller and winning bidder; broker's broker allegedly violated MSRB Rule G-17 by accepting bids after bid deadline); SEC v. Wolfe & Hurst Bond Brokers, Inc. et al., Securities Exchange Act Release No. 59913 (May 13, 2009) (settlement in connection with alleged violation of MSRB Rule G-17 by broker's broker for dissemination of fake cover bids to both seller and winning bidder and for lowering of the highest bids to prices closer to the cover bids without informing either bidders or sellers). These cases also involved violations of MSRB Rules G-8, G-9, and G-28.

interpretive guidance for dealers that use broker's brokers. The MSRB has requested that the proposed rule change be made effective six months after approval by the Commission.

A. MSRB Rule G-43

Definition of Broker's Broker. The MSRB proposes to define a broker's broker as "a dealer, or a separately operated and supervised division or unit of a dealer, that principally effects transactions for other dealers or that holds itself out as a broker's broker," whether as a separate company or as part of a larger company.<sup>11</sup> An alternative trading system ("ATS") registered with the Commission will not be considered a broker's broker for purposes of MSRB Rule G-43 if it meets the following criteria with respect to its municipal securities activities: (1) the ATS utilizes only automated and electronic means to communicate with bidders and sellers in a systematic and non-discretionary fashion (with the exception of communications that are solely clerical or ministerial in nature and communications that occur after a trade has been executed); (2) the ATS limits customers to sophisticated municipal market professionals (SMMPs), as defined in MSRB Rule D-9; and (3) the ATS adopts and complies with specified policies and procedures.<sup>12</sup>

Duty of Broker's Broker. MSRB Rule G-43(a)(i) would require a broker's broker, in executing a transaction in municipal securities for or on behalf of another dealer, to make a reasonable effort to obtain a price for the dealer that was fair and reasonable in relation to prevailing market conditions and employ the same care and diligence in doing so as if the

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<sup>11</sup> See MSRB Rule G-43(d)(iii).

<sup>12</sup> See id. As proposed, the policies and procedures an ATS adopts must, at a minimum, require the ATS to (1) disclose the nature of its undertakings for the seller and bidder in bid-wanted and offerings; (2) disclose the manner in which it will conduct bid-wanted and offerings; and (3) prohibit the ATS from engaging in the conduct described in MSRB Rule G-43(c)(i)(H)–(O) (described more fully below).

transaction were being done for its own account. The MSRB states that MSRB Rule G-43(a)(i) incorporates the same basic duty currently found in MSRB Rule G-18.<sup>13</sup>

Under MSRB Rule G-43(a)(ii), a broker's broker that undertakes to act for or on behalf of another dealer in connection with a transaction or potential transaction in municipal securities would be prohibited from taking any action that would work against that dealer's interest to receive advantageous pricing. MSRB Rule G-43(a)(iii) would establish a presumption that a broker's broker is acting for or on behalf of the seller<sup>14</sup> in a bid-wanted, unless both the seller and bidders agreed otherwise in writing in advance of the bid-wanted.

Safe Harbor in Conduct of Bid-Wanted. The MSRB proposes to create a safe harbor for broker's brokers in conducting bid-wanted. Under the safe harbor, a broker's broker would satisfy its pricing duty under proposed subsection (a)(i) if it conducts bid-wanted in the manner described in MSRB Rule G-43(b). A broker's broker, unless otherwise directed by the seller,<sup>15</sup> would be required to make a reasonable effort to disseminate a bid-wanted widely.<sup>16</sup> If securities are of limited interest, the broker's broker must make a reasonable effort to reach dealers with specific knowledge of the issue or known interest in comparable securities.<sup>17</sup> Further, each bid-

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<sup>13</sup> The MSRB has proposed deleting text from MSRB Rule G-18 to eliminate duplication relating to this pricing duty as it will be covered by MSRB Rule G-43(a)(i). See Notice, 77 FR at 17550.

<sup>14</sup> The MSRB proposes to define a "seller" as the selling dealer, or potentially selling dealer, in a bid-wanted or offering and would not include the customer of a selling dealer. See MSRB Rule G-43(d)(ix).

<sup>15</sup> See infra Section I.C (summarizing interpretive guidance noting that selling dealers that direct broker's brokers to filter certain bidders from the receipt of bid-wanted or offerings should be able to demonstrate the reasons for filtering, that it is for valid business reasons, and that it is not anti-competitive).

<sup>16</sup> See MSRB Rule G-43(b)(i).

<sup>17</sup> See MSRB Rule G-43(b)(ii).

wanted must have either a “sharp” deadline or an “around time” deadline for the acceptance of bids or changes to bids.<sup>18</sup>

To avail itself of the safe harbor, a broker’s broker must adopt predetermined parameters designed to identify possible bids that do not represent the fair market value of the municipal securities subject to the bid-wanted.<sup>19</sup> In addition, the broker’s broker must test the predetermined parameters periodically to determine whether they are achieving their purpose.<sup>20</sup> If the high bid is outside of the predetermined parameters and the broker’s broker believes that the bid might have been submitted in error, the broker’s broker may contact the high bidder about its bid price prior to the deadline for bids without the seller’s consent.<sup>21</sup> However, if the high bid is within the predetermined parameters, the broker’s broker must obtain the seller’s oral or written consent before contacting the bidder to determine whether the bid was submitted in error.<sup>22</sup>

Finally, the broker’s broker would be required to disclose to the seller if the highest bid received in a bid-wanted is below the predetermined parameters and receive the seller’s oral or written acknowledgement of the disclosure before proceeding with the trade.<sup>23</sup> According to the MSRB, this notice would inform the selling dealer that the high bid in a bid-wanted might be off-market and not representative of the fair market value.<sup>24</sup> The selling dealer would then need to

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<sup>18</sup> See MSRB Rule G-43(b)(iii).

<sup>19</sup> See MSRB Rule G-43(c)(i)(F).

<sup>20</sup> See id.

<sup>21</sup> See MSRB Rule G-43(b)(iv).

<sup>22</sup> See id. In all events, under MSRB Rule G-43(c)(i)(D), the broker’s broker must notify the seller if the high bidder’s bid or the cover bid had been changed prior to execution and provide the seller with the original and changed bids.

<sup>23</sup> See MSRB Rule G-43(b)(v).

<sup>24</sup> See Notice, 77 FR at 17550.

satisfy itself that the high bid was, in fact, fair and reasonable if it wished to purchase the securities from its customer at that price as a principal.<sup>25</sup>

Policies and Procedures. The MSRB proposes to establish policies and procedures that a broker's broker must adopt and comply with in the operation of bid-wanted and offerings for municipal securities.<sup>26</sup> According to the MSRB, MSRB Rule G-43(c) is designed to ensure that bid-wanted and offerings are conducted in a fair manner.<sup>27</sup> MSRB Rule G-43(c) would apply to all bid-wanted and offerings, including bid-wanted conducted under the safe harbor in MSRB Rule G-43(b).<sup>28</sup> While many of the requirements of MSRB Rule G-43(c) address behavior that would also be a violation of MSRB Rule G-17, MSRB Rule G-43(c) would not supplant the requirements of MSRB Rule G-17.<sup>29</sup>

A broker's broker would be required, among other things, to describe the manner in which it will conduct its bid-wanted and offerings.<sup>30</sup> Additionally, if a broker's broker conducts bid-wanted not in accordance with the safe harbor under MSRB Rule G-43(b), it must describe in detail how it will satisfy its obligations under MSRB Rule G-43(a)(i).<sup>31</sup> If a broker's broker allows customers or affiliates of the broker's broker to place bids, the broker's broker must disclose that fact to both sellers and bidders in writing, and must disclose to the seller prior to a transaction if the high bid in a bid-wanted or offering is from a customer or an affiliate (but

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<sup>25</sup> See id. See also infra Section I.C. (highlighting existing duties of dealers regarding fair and reasonable prices).

<sup>26</sup> See MSRB Rule G-43(c)(i).

<sup>27</sup> See Notice, 77 FR at 17550.

<sup>28</sup> See id.

<sup>29</sup> See id.

<sup>30</sup> See MSRB Rule G-43(c)(i)(B).

<sup>31</sup> See MSRB Rule G-43(c)(i)(G).

would not need to disclose the name of the customer or affiliate).<sup>32</sup> MSRB Rule G-43(c)(i)(H) would prohibit a broker's broker from maintaining municipal securities in any proprietary or other accounts, other than for clearance and settlement purposes.

Once a broker's broker has selectively informed a bidder whether its bid is being used in the bid-wanted, the broker's broker cannot accept a changed bid or a new bid in the same bid-wanted.<sup>33</sup> In Amendment No. 1, the MSRB proposed amending MSRB Rule G-43(c)(i)(N) to clarify that it would prohibit a broker's broker only from accepting a new bid or a changed bid from a bidder in a bid-wanted after the broker's broker has notified that same bidder whether its bid was the high bid ("being used") in the same bid-wanted. According to the MSRB's statements in Amendment No. 1, MSRB Rule G-43(c)(i)(N), as originally proposed, might otherwise have been read to prohibit new or changed bids from any bidders after another bidder has been informed of whether its bid was being used in a bid-wanted, which was not the MSRB's intent.

Until the completion of a bid-wanted, a broker's broker would be prohibited from disclosing information about bid prices to anyone other than the seller and winning bidder unless the broker's broker makes such information available to all market participants on an equal basis at no cost while disclosing that the bids may not be representative of fair market value and that it is making this information public.<sup>34</sup> A bid-wanted will be considered "completed" when either (A) the security is traded, whether through the broker's broker or otherwise, or (B) the broker's broker is notified by the seller that the security will not trade.<sup>35</sup> In Amendment No. 1, the MSRB

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<sup>32</sup> See MSRB Rule G-43(c)(i)(E).

<sup>33</sup> See MSRB Rule G-43(c)(i)(N).

<sup>34</sup> See MSRB Rule G-43(c)(i)(O).

<sup>35</sup> See MSRB Rule G-43(d)(iv).



proposed adding paragraph (x) to MSRB Rule G-43(d), which would clarify that a municipal security would be considered to have “traded” through a broker’s broker when it has been purchased by the broker’s broker from the seller and sold to the bidder by the broker’s broker, as an intermediary.<sup>36</sup>

#### B. Recordkeeping Requirements

The MSRB proposes amending MSRB Rules G-8 and G-9 to establish recordkeeping requirements for broker’s brokers and ATs in connection with their municipal securities activities. According to the MSRB, the proposed amendments would assist in the enforcement of MSRB Rule G-43.<sup>37</sup> A broker’s broker would be required to keep records of bids; offers; changed bids and offers; the time of notification to the seller of the high bid; the policies and procedures of the broker’s broker concerning bid-wanted and offerings; and any agreements by which bidders and sellers agree to joint representation by the broker’s broker.<sup>38</sup> In addition, a broker’s broker would be required to keep records of communications with bidders and sellers regarding possibly erroneous bids;<sup>39</sup> communications with sellers when the high bid is below

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<sup>36</sup> Because a broker’s broker is an intermediary and would be prohibited by MSRB Rule G-43(c)(i)(H) from engaging in proprietary trading, a trade through a broker’s broker would have two sides: a purchase from the seller and a sale to the bidder. The term “traded” would be used in MSRB Rule G-43(d)(iv), which would define when a bid-wanted is considered “completed.” This characterization of a trade for purposes of MSRB Rule G-43 does not affect how trades are to be treated under any other MSRB rule, including but not limited to MSRB Rule G-14 on reports of sales or purchases.

<sup>37</sup> See Notice, 77 FR at 17550.

<sup>38</sup> See id. The MSRB also proposes recordkeeping requirements for ATs with respect to their municipal securities activities. See MSRB Rule G-8(a)(xxvi). A broker’s broker or AT that is a separately operated and supervised division or unit of another dealer must keep separately maintained or separately extractable records of its municipal securities activities. See MSRB Rule G-8(a)(xxv)(K), (xxvi)(D). See also infra note 65 and accompanying text (discussing the comparability in recordkeeping requirements for broker’s brokers and ATs).

<sup>39</sup> See MSRB Rule G-8(a)(xxv)(D).

predetermined parameters;<sup>40</sup> and the setting of predetermined parameters.<sup>41</sup> The MSRB proposes requiring these records be maintained for six years.<sup>42</sup>

C. Notice to Dealers that Use the Services of Broker's Brokers

The Proposed Notice provides guidance on the roles and duties of other transaction participants (i.e., brokers, dealers, and municipal securities dealers) that sell and bid for municipal securities in bid-wanted and offerings conducted by broker's brokers. Dealers that submit bids to broker's brokers that they believe are below the fair market value of the securities or that submit "throw-away" bids to broker's brokers would violate MSRB Rule G-13.<sup>43</sup> The Proposed Notice would also remind selling dealers that use the services of broker's brokers that they have an independent duty under MSRB Rule G-30 to determine that the prices at which they purchase municipal securities as principal from their customers are fair and reasonable.<sup>44</sup> In addition, a selling dealer that directs broker's brokers to filter certain bidders from the receipt of bid-wanted should be able to demonstrate the reasons for filtering and that it is for valid business reasons, not anti-competitive behavior.<sup>45</sup> The Proposed Notice also urges selling dealers not to assume that their customers need to liquidate their securities immediately without inquiring as to their customers' particular circumstances and discussing with their customers the possible improved pricing benefit associated with taking additional time to liquidate their securities.<sup>46</sup> Finally, the Proposed Notice provides that, depending upon the facts and

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<sup>40</sup> See MSRB Rule G-8(a)(xxv)(E).

<sup>41</sup> See MSRB Rule G-8(a)(xxv)(J).

<sup>42</sup> See MSRB Rule G-9(a)(xii)–(xiii).

<sup>43</sup> See Notice, 77 FR at 17551.

<sup>44</sup> See Notice, 77 FR at 17550.

<sup>45</sup> See id.

<sup>46</sup> See id.

circumstances, the use of bid-wanted by selling dealers solely for price discovery purposes, with no intention of selling the securities through the broker's brokers, may be an unfair practice within the meaning of MSRB Rule G-17.<sup>47</sup>

### III. Summary of Comments Received and the MSRB's Response

As previously noted, the Commission received six comment letters on the proposed rule change.<sup>48</sup> Three of the commenters expressed general support for the proposed rule change.<sup>49</sup> However, two of the commenters questioned the need for the proposed rule change;<sup>50</sup> one objected to the definition of "broker's broker";<sup>51</sup> two asked for clarification related to the exemption for ATSS from the definition of broker's broker;<sup>52</sup> one questioned the presumption that a broker's broker acts for the seller in a bid-wanted;<sup>53</sup> four expressed concerns with the requirement to adopt policies and procedures to disclose customers and affiliates;<sup>54</sup> two objected to the predetermined parameters aspect of the safe harbor;<sup>55</sup> one objected to the prohibition on holding municipal securities;<sup>56</sup> and one opposed the recordkeeping requirement of MSRB Rule G-8.<sup>57</sup>

#### A. General Opposition to the Proposed Rule Change

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<sup>47</sup> See Notice, 77 FR at 17550–51.

<sup>48</sup> See supra note 4.

<sup>49</sup> See CTP Letter, RWS Letter, TMC Letter.

<sup>50</sup> See AAM Letter, BDA Letter.

<sup>51</sup> See AAM Letter.

<sup>52</sup> See BDA Letter, TMC Letter

<sup>53</sup> See BDA Letter.

<sup>54</sup> See BDA Letter, CTP Letter, HTD Letter, RWS Letter.

<sup>55</sup> See BDA Letter, TMC Letter.

<sup>56</sup> See AAM Letter.

<sup>57</sup> See BDA Letter.

Advisors Asset Management, Inc. (“AAM”) and the Bond Dealers of America (“BDA”) questioned the need for MSRB Rule G-43 and said current MSRB rules and prior enforcement actions have proven sufficient to address the behaviors the proposed rule change is intended to address.<sup>58</sup> In its response, the MSRB stated its belief that a specific rule governing the conduct of broker’s brokers is warranted. While MSRB Rule G-17 is broad in its scope and could be used to address much of the conduct of broker’s brokers described in Commission and FINRA enforcement proceedings, the MSRB believes that broker’s brokers need more explicit direction as to the appropriate conduct of bid-wanted and offerings. The MSRB believes it can sometimes be difficult for enforcement agencies to prove that conduct is fraudulent, and alleged violators of MSRB Rule G-17 sometimes argue that they have not been put properly on notice of the type of conduct that is considered unfair. The MSRB notes that MSRB Rule G-43 would not replace MSRB Rule G-17, which is an overarching rule and applies even when there is a more specific rule on point.

B. Definition of Broker’s Broker

AAM believes that the proposed definition of broker’s broker is extraordinarily broad, and suggested a more-detailed definition of broker’s broker that includes the nature, role, duties, and responsibilities of a broker’s broker. The MSRB stated its continued belief that a functional definition of broker’s broker is appropriate. According to the MSRB, the Securities Industry and Financial Markets Association (“SIFMA”) made a similar comment in response to an earlier draft of MSRB Rule G-43. The MSRB responded then that the definition proposed by SIFMA would make it easy for a firm to escape classification as a broker’s broker and, accordingly, avoid application of the rules for broker’s brokers. For example, a firm could simply carry

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<sup>58</sup> See AAM Letter, BDA Letter.

customer accounts and avoid classification as a broker's broker because part of SIFMA's proposed definition is that the firm does not carry customer accounts. In comparison, the MSRB believes its definition focuses on the key function of a broker's broker—effecting transactions in municipal securities on behalf of other dealers.

AAM also believes that the MSRB has not defined or provided sufficient guidance regarding what it means for a dealer to “hold[] itself out as a broker's broker” and should be omitted. The MSRB has previously noted that selling dealers rely on broker's brokers as trusted intermediaries and that a selling dealer should be entitled to rely on the representations of another dealer that it is functioning as a broker's broker. According to the MSRB, a dealer should not call itself a broker's broker if it does not want to be subject to MSRB Rule G-43 (and should not be able to avoid the provisions of MSRB Rule G-43 simply by not calling itself a broker's broker).

C. ATS Exemption from Definition of Broker's Broker

BDA requested that the MSRB clarify the types of communications engaged in by ATSs that would be considered “clerical or ministerial.” The MSRB noted that MSRB Rule G-3 (which provides that an individual whose duties are solely clerical and ministerial is not required to pass an MSRB professional qualifications examination) already provides guidance on what communications are clerical or ministerial. Examples of clerical or ministerial communications would be customer service types of communications, such as IT questions. Any type of communication that could only be engaged in by an individual that is licensed under MSRB Rule G-3 would not be considered to be clerical or ministerial.

TMC Bonds, LLC (“TMC”) stated its belief that an ATS should be allowed to provide voice support without being considered a broker's broker, and suggested that software support

that helps users navigate a large amount of data would be precluded under the definition. In its response, the MSRB expressed concerns regarding voice communication between ATS traders and bidders. If traders have access to information about bids, there is no way to ensure that they do not engage in the same types of activities that have been the subject of enforcement actions against traditional voice brokers (e.g., bid coaching by the broker). The MSRB noted that some purely electronic ATSs have developed mechanisms for bidders to request automatic electronic alerts when securities of the type in which they have interest are available on the ATS. Software support, in comparison, would likely fall into the category of clerical or ministerial communications, which are not precluded by the definition.

D. Broker's Broker As Representative of Seller

BDA believes that the presumption that a broker's broker acts for or on behalf of the seller in a bid-wanted for municipal securities unless both the seller and bidders agree otherwise in writing in advance of the bid-wanted may discourage potential buyers from bidding and reduce liquidity in the municipal securities market. The MSRB disagreed with BDA's comment. According to the MSRB, many broker's brokers require their clients, including dealers, to sign agreements prior to effecting trades through them. If a broker's broker desires to represent bidders as well as sellers in bid-wanted, it could simply include a clause in client agreements. Sellers and bidders could then decide whether to execute the agreement and thereby agree to dual representation.

E. Disclosure of Customers and Affiliates

BDA, Chapdelaine Tullett Prebon, LLC ("CTP"), Hartfield, Titus & Donnelly ("HTD"), and RW Smith & Associates, Inc. ("RWS") objected to the portion of MSRB Rule G-43(c)(i)(E) concerning pre-trade disclosure by the broker's broker to the selling dealer of the fact that the

high bidder is a customer of the broker's broker. BDA also objected to the portion of that rule requiring pre-trade disclosure if the high bidder is an affiliate of the broker's broker. One concern was that such disclosures would be inconsistent with the counter-party anonymity provided by most broker's brokers. In its response, the MSRB reiterated that the primary role of a broker's broker is that of a trusted intermediary between selling and bidding dealers. The MSRB is concerned that a broker's broker effecting trades with a customer or an affiliate is presented with conflicts of interest that should be disclosed, but noted that the proposed rule would not require disclosure of the name of the customer or affiliate.

F. Predetermined Parameters

BDA disagreed with the premise that it is the obligation of a broker's broker to determine what is a fair price, or a range of fair prices. In its response, the MSRB reiterated that existing MSRB Rule G-18 already requires broker's brokers to "make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions." The MSRB has simply proposed to move that same pricing obligation into MSRB Rule G-43(a)(i). The proposed rule does not adopt the stricter pricing obligation found in MSRB Rule G-30, which prohibits dealers from purchasing or selling municipal securities to customers as principals at prices that are not fair and reasonable. However, MSRB Rule G-30 does apply if a broker's broker engages in municipal securities transactions with customers as a principal.

In addition, BDA expressed concerns that in times of volatile markets, many bids could be outside the predetermined parameters, which would require the broker's broker to contact numerous bidders or sellers. The MSRB responded that in times of volatile markets, a broker's broker may adjust its predetermined parameters as necessary to achieve their purpose of identifying most bids that do not represent fair market value. Furthermore, broker's brokers

using the safe harbor would not be required to contact bidders under any circumstances; they are simply permitted to do so under certain circumstances if they use predetermined parameters.

Broker's brokers would be required, however, to contact sellers when the high bid is below the predetermined parameters. According to the MSRB, this notice would draw potentially below market bids to the attention of selling dealers and is important to facilitating the receipt of fair market prices by retail investors. The actual determination of whether the high bid is, in fact, below market, however, would remain the obligation of the selling dealer. Finally, the MSRB stated that the safe harbor is completely optional.

BDA also said that a broker's broker could set the pricing too broadly on the upper end (which could affect the outcome of the bid-wanted and future bids, thereby reducing liquidity and leading to lower prices) or too narrowly on the lower end (which could lead a selling broker not to go through with a trade, or risk litigation risk if it did). In response, the MSRB stated its belief that the requirements related to predetermined parameters should be sufficient to avoid the situations described by BDA. By definition, the predetermined parameters must be reasonably designed to identify most bids that may not represent the fair market value of municipal securities that are the subject of bid-wanted to which they are applied. Furthermore, broker's brokers that use predetermined parameters would be required to test them periodically to determine whether they have identified most bids that did not represent the fair market value of municipal securities.

TMC believes that establishing predetermined parameters would force broker's brokers to subscribe to pricing services, as they do not have the resources to create their own pricing models for all outstanding securities. In addition, TMC believes that intermediaries, whether ATSs, broker's brokers, or exchanges, should not be responsible for setting prices or price bands,



but instead should be responsible for running fair and efficient auctions. According to the MSRB, the use of predetermined parameters was suggested by a broker's broker as part of the comment process on an earlier version of MSRB Rule G-43. The MSRB noted that many broker's brokers and ATSs already notify sellers when bids differ significantly from bids received in previous bid-wanted or offerings, recent trade prices on EMMA, or prices from pricing services. Furthermore, bidders using one ATS's software already receive an electronic notification if their bids are outside of certain pricing parameters and are required to take affirmative steps to resubmit their bids in such cases. Finally, the MSRB stated that the predetermined parameters established by broker's brokers pursuant to MSRB Rule G-43 are intended to assist broker's brokers in their duties with respect to their clients and are not dispositive of the fair market value of the securities that are the subject of bid-wanted.

G. Prohibition on Holding Municipal Securities

AAM believes that the current definition of broker's broker, coupled with MSRB Rule G-43(c)(i)(H), would require broker-dealers that have historically participated in new issue syndicates and proprietary trading to exit those portions of their businesses. The MSRB disagreed with AAM's concern and noted that it would be highly unlikely for such firms to be considered to "principally effect transactions for other dealers" or to "hold themselves out as broker's broker," either of which is required for a dealer to be considered a "broker's broker" under MSRB Rule G-43(d)(iii). The MSRB reiterated that it has proposed a separate restriction on proprietary trading by broker's brokers, rather than incorporating the concept of proprietary trading into the definition of "broker's broker," because the latter approach would allow a dealer to avoid characterization as a broker's broker simply by executing a handful of proprietary trades.

#### H. Recordkeeping Requirements

BDA believes the record-keeping requirements are burdensome, especially those concerning offerings. According to the MSRB, the recordkeeping provisions of the proposed rule change are designed to permit effective enforcement of MSRB Rule G-43, and many were recommended by broker's brokers themselves. The MSRB noted that the proposed rule change already reflects a change from a previous version made at the request of broker's brokers concerned with the recordkeeping provisions for offerings. As the MSRB noted in its filing, "The MSRB agrees with the comments concerning records of offers and has amended the rule to require that a broker's brokers' [sic] records concerning offers must include the time of first receipt and the time the offering has been updated for display or distribution."<sup>59</sup> A broker's broker would not need to keep records for every change in offering price throughout the course of the day.

#### IV. Discussion and Commission Findings

The Commission has carefully considered the proposed rule change, as modified by Amendment No. 1 thereto, as well as the comment letters received and the MSRB's response, and finds that the proposed rule change, as amended, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the MSRB.<sup>60</sup> In particular, the proposed rule change is consistent with Section 15B(b)(2)(C) of the Exchange Act, which provides that the MSRB's rules shall be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with

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<sup>59</sup> See Notice, 77 FR at 17556.

<sup>60</sup> In approving the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

respect to, and facilitating transactions in municipal securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest.<sup>61</sup>

The Commission believes the proposed rule change is reasonably designed to prevent fraudulent and manipulative acts and practices, protect investors, and to remove impediments to and perfect the mechanism of a free and open market in municipal securities by providing more explicit direction to broker's brokers in conducting bid-wanted and offerings and by promoting additional transparency concerning the services of and prices received from broker's brokers. A number of recent Commission and FINRA enforcement actions alleged conduct in bid-wanted and offerings in violation of MSRB Rule G-17 and other MSRB rules.<sup>62</sup> According to the MSRB, enforcement agencies continue to observe transactions and trading patterns of broker's brokers that may cause customers to receive unfair prices when liquidating their municipal securities through broker's brokers.<sup>63</sup> The proposed rule change is designed to address these issues by providing broker's brokers with advance notice of the type of conduct that is considered unfair in the conduct of bid-wanted and offerings, and by promoting additional transparency to dealers concerning prices received through broker's brokers.

In addition, the proposed rule change is reasonably designed to prevent fraudulent and manipulative acts and practices and to protect investors by promoting better understanding of conduct in the municipal securities market, which should in turn promote more efficient compliance with and enforcement of Rule G-43. Specifically, MSRB Rules G-8 and G-9 would

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<sup>61</sup> 15 U.S.C. 78o-4(b)(2)(C).

<sup>62</sup> See supra note 10. See also Notice, 77 FR at 17549 n.4.

<sup>63</sup> See Notice, 77 FR at 17551.

require broker's brokers and ATSS to keep records of their activities in bid-wanted. According to the MSRB, many of the recordkeeping provisions were recommended by broker's brokers. While MSRB Rule G-8 establishes different recordkeeping requirements for broker's brokers and ATSS,<sup>64</sup> the Commission believes the recordkeeping requirements are appropriately tailored to ensure the availability of records pertaining to the municipal securities activities of broker's brokers and ATSS. The Commission notes that, in addition to the recordkeeping requirements of MSRB Rule G-8(a)(xxvi), ATSS are also subject to the recordkeeping requirements of Regulation ATS.<sup>65</sup> When taken together, the recordkeeping requirements for ATSS under Regulation ATS and MSRB Rule G-8(a)(xxvi) are comparable to the applicable requirements for broker's brokers under MSRB Rule G-8(a)(xxv).

In light of the MSRB's responses to comments received, the Commission does not believe that any comment raises an issue that would preclude approval of this proposal. According to the MSRB, it has worked extensively with broker's brokers and other dealers to refine the proposed rule change so that it targets abuses more accurately, while minimizing the likelihood of adversely affecting liquidity.<sup>66</sup> MSRB Rule G-43 should promote improved

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<sup>64</sup> Cf. infra note 65 and accompanying text (discussing additional recordkeeping requirements imposed by Regulation ATS).

<sup>65</sup> See 17 CFR 242.300 et seq. For example, Rule 302 of Regulation ATS requires an ATS to make and keep time-sequenced records of order information in the ATS, including, among other things, the date and time that an order was received; the identity of the security; the principal amount of bonds to which the order applies; any designation(s) related to the order; any instructions to modify or cancel the order; the date and time that an order was executed; the price at which an order was executed; the size of the order executed; and the identity of the parties to the transaction. See 17 CFR 242.302(c).

<sup>66</sup> See Notice, 77 FR at 17551. The MSRB has proposed three versions of proposed MSRB Rule G-43 that would apply to broker's brokers. See MSRB Notice 2010-35, Request for Comment on MSRB Guidance on Broker's Brokers (Sep. 9, 2010); MSRB Notice 2011-18, Request for Comment on Draft Rule G-43 (on Broker's Brokers) and Associated Amendments to Rules G-8 (on Books and Records), G-9 (on Preservation of Records), and on G-18 (on Execution of Transactions) (Feb. 24, 2011); MSRB Notice 2011-50,

pricing in the secondary market for retail investors in municipal securities by encouraging the wide dissemination of bid-wanted and identifying fraudulent and unfair conduct that may result in retail investors receiving lower prices than would otherwise be available. In addition, the Proposed Notice, which would remind dealers of their pricing obligations, appears reasonably designed to provide investors with fair and reasonable prices for municipal securities.

The Commission also believes that the proposed exemption from the definition of broker's broker for certain ATSs does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>67</sup> The Commission notes that an ATS will not be considered a broker's broker only if it meets the requirements of MSRB Rule G-43(d)(iii). To satisfy this exemption, the ATS must conform its conduct to certain conditions. First, the ATS must utilize only automated and electronic means to communicate with bidders and sellers in a systematic and non-discretionary fashion, with the exception of communications that are solely clerical or ministerial in nature and communications that occur after a trade has been executed. Second, all customers of the ATS, if any, must be SMMPs. Third, the ATS must adopt and comply with specified policies and procedures<sup>68</sup> that would, among other things, require that the ATS disclose the nature of its undertaking for the seller and bidders in bid-wanted and offerings and the manner in which it will conduct bid-wanted and offerings,<sup>69</sup> as

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Request for Comment on Revised Draft Rule G-43 (on Broker's Brokers), Associated Revised Draft Amendments to Rule G-8 (on Books and Records) and Rule G-9 (on Preservation of Records), and Draft Interpretive Notice on the Obligations of Dealers that Use the Services of Broker's Brokers (Sep. 8, 2011).

<sup>67</sup> 15 U.S.C. 78o-4(b)(2)(C).

<sup>68</sup> See supra note 12 and accompanying text.

<sup>69</sup> See MSRB Rule G-43(d)(iii)(C)(1)–(2). The Commission notes that a broker's broker also must disclose the nature of its undertaking for the seller and bidders in bid-wanted and offerings and the manner in which it will conduct bid-wanted and offerings, and describe in detail how such broker's broker will satisfy its obligations under the rule if it

well as prohibit the ATS from giving preferential information to bidders in bid-wanted, including but not limited to “last looks” (e.g., directions to a bidder that it “review” its bid or that its bid is “sticking out”).<sup>70</sup> These policies and procedures are substantially similar to those applicable to broker’s brokers. To the extent an ATS fails to meet any of the requirements of the exemption under MSRB Rule G-43(d)(iii), the ATS will be considered a broker’s broker and thus subject to all of the requirements of MSRB Rule G-43. The Commission agrees with the MSRB that ATSs subject to the exemption from the definition of broker’s broker will remain subject to most of the requirements of MSRB Rule G-43(c).<sup>71</sup> For these reasons, the Commission believes that the proposed exemption from the definition of broker’s broker for certain ATSs does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>72</sup>

## V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the MSRB, and in particular, Section 15B(b)(2)(C)<sup>73</sup> of the Exchange Act. The proposal will become effective six months after the date of this order.

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chooses not to conduct bid-wanted in accordance with MSRB Rule G-43(b). See MSRB Rule G-43(c)(i)(A)–(B) and (G). The Commission believes broker’s brokers and ATSs should provide clear and transparent disclosure sufficient to understand their conduct of bid-wanted and offerings.

<sup>70</sup> See MSRB Rule G-43(d)(iii)(C)(3); MSRB Rule G-43(c)(i)(K).

<sup>71</sup> See Notice, 77 FR at 17550. See also *supra* note 65 and accompanying text (discussing the combined recordkeeping obligations of ATSs in MSRB Rule G-8 and Regulation ATS).

<sup>72</sup> 15 U.S.C. 78o-4(b)(2)(C).

<sup>73</sup> 15 U.S.C. 78o-4(b)(2)(C).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,<sup>74</sup> that the proposed rule change (SR-MSRB-2012-04), as modified by Amendment No. 1, is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>75</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>74</sup> 15 U.S.C. 78s(b)(2).

<sup>75</sup> 17 CFR 200.30-3(a)(12).