360 Madison Avenue
New York, NY 10017-7111
Telephone 646.637.9200
Fax 646.637.9126
www.bondmarkets.com

1399 New York Avenue, NW
Washington, DC 20005-4711
Telephone 202.434.8400
Fax 202.434.8456

St. Michael's House
1 George Yard
London EC3V 9DH England
Telephone 44.20.77 43 93 00
Fax 44.20.77 43 93 01

THE BOND MARKET ASSOCIATION

May 9, 2003

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: MSRB Proposed Change to Rule G-14; File No. SR-MSRB-2003-02

Dear Mr. Katz:

The Bond Market Association (Association)[1] is pleased to comment on the proposal by the Municipal Securities Rulemaking Board (MSRB) with regard to its Rule G-14 on reports of purchases or sales of municipal securities. In substance, the MSRB is proposing to increase the transparency requirements for municipal securities such that trade details on every trade will be publicly disseminated on a next-day basis.

General Comments

The Association consistently has supported the overall goal of increased transparency in the municipal market and the MSRB's recent initiatives related to that goal.[2] As we have previously indicated, we have concerns about the potential impact of real-time transparency on the market for less-frequently traded bonds. Although we do not oppose the move to next-day transparency, we believe that it should only be undertaken in connection with a more deliberate study of potential liquidity effects from a move to real-time transparency, consistent with the approach taken by the NASD and endorsed by the Commission in the area of corporate bond transparency.

In our August 2002 Comment Letter, the Association supported the MSRB's proposal to extend next-day dissemination of trade information to bonds that trade at least two times per day, and this proposal subsequently was adopted by the Commission. We

[1] The Association represents securities firms and banks that underwrite, distribute, and trade in fixed income securities, both domestically and internationally. More information about the Association is available on its web site, http://www.bondmarkets.com. The Association's Municipal Securities Division Executive and Legal Advisory Committees have been consulted in providing these comments.
[2] *See*, *e.g.*, Letter from Frank Chin, Chair, Municipal Executive Committee, TBMA, to Mr. Jonathan G. Katz, Secretary, SEC, dated August 8, 2002, commenting on File No. SR-MSRB-2002-07 ("August 2002 Comment Letter").

also supported the introduction of intra-day dissemination for the same class of bonds, when the implementation of real-time trade reporting makes intra-day reporting possible. At the same time, we expressed concern about the possible impact of price dissemination on the liquidity of the market for some inactively traded bonds, and we suggested that the MSRB endeavor to address this issue in a deliberate and coordinated way. We continue to believe that careful review of potential liquidity effects is important to achieving maximum transparency without an adverse market impact.

<u>Transparency and Liquidity</u>

The relationship between price dissemination and liquidity exists because, particularly in the case of infrequently traded bonds, the willingness of dealers to trade with counterparties depends on the analysis by each dealer of how much risk it is likely to assume in connection with a particular trade, coupled with its ability effectively to manage that risk, either by entering into an offsetting trade with another party or entering into hedging transactions. For inactively traded bonds, the publication of price information, particularly in block size, may provide information to other market participants that would affect the ability of a holder of the same bonds to sell them without incurring a loss.

The ability of a dealer to manage its risk in connection with a particular trade, and therefore, the potential liquidity impact, obviously is also affected by the length of time between trade execution and dissemination of information to the marketplace. Our concerns are heightened by the fact that the MSRB has indicated that it intends to issue a Concept Release by the end of this month outlining a proposal to move from next-day dissemination to real-time dissemination by mid-2004.

Adverse effects on liquidity could be particularly harmful for retail investors, who rely on the dealer community to provide liquidity on an ongoing basis, and who may have a substantial portion of individual assets allocated to municipal bonds. Indeed, the municipal bond market is the fixed income sector with the highest proportion of direct retail investor participation.[3] Institutional investors holding complex, "story," or high yield bonds also may be legitimately concerned that quick dissemination will impact the price at which they are able to dispose of particular bonds, perhaps in circumstances in which legal requirements compel them to dispose of bonds that have fallen in credit quality.

In addition, in terms of the benefits to investors of transparency, it is not clear that real-time dissemination always provides significant comparative benefits. Particularly as

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[3] According to the Federal Reserve System's Flow of Funds data for the fourth quarter of 2002, individual households held directly $660 billion in municipal securities, or 35% of the amount outstanding.

concerns infrequently traded bonds, the benefit to investors of obtaining information to determine whether they have received an appropriate execution price will not be materially enhanced by real-time disclosure. Retail investors are unlikely to access bond prices on an intra-day basis. Further, institutional asset managers who need to calculate net asset value can do so on the basis of end-of-day prices.

The MSRB's proposal to provide price information on trades of more than $1 million without disclosing actual size represents an attempt to address at least in part these concerns. We support this concept, but we believe that further review is necessary to determine whether the $1 million limit is the appropriate one, or whether the same limit should apply to all municipal bonds. For example, it might be appropriate to disclose actual trade size up to a limit larger than $1 million in the case of bonds with a larger initial issuance size and/or higher credit rating. A similar approach with regard to corporate bond transparency was adopted by the NASD, which under its TRACE rules discloses actual size up to $5 million for investment grade bonds. Although there are differences between the corporate and municipal bond markets that may well dictate a different scheme for disclosure of size of large municipal trades, further review and analysis is necessary before reaching any conclusions.

Studying Liquidity Impacts

The outreach that the Association has undertaken to other market participants, including securities firms and institutional buy-side participants, convinces us that the potential negative liquidity impact of real-time dissemination on the market for some municipal bonds is real. Accordingly, we have formed a Price Transparency Task Force, which includes substantial participation by buy-side institutions. The Task Force is in the process of engaging a team of independent economists to gather any available data, including data that is published by the MSRB under the current regime, to conduct an analysis of the liquidity question.

In conducting a study of liquidity impacts, whether by the Association, the MSRB, or others, an analysis of the impact of next-day price dissemination on the market for inactively traded bonds could be especially useful in analyzing potential liquidity impacts of real-time dissemination. Accordingly, we do not oppose the concept of disclosing all bond prices on a next-day basis, but we believe that this step should be part of a deliberate and conscious effort to study potential liquidity impacts in order to make reasonable decisions about how much of the market should be subject to real-time price dissemination.

Further, in order to undertake such a review, the time table for moving to real-time transparency may need to be adjusted. The time frame for requiring dealers to report all trades on a real-time basis should not dictate the timing of price dissemination requirements, particularly where there are open questions about the market impact of such dissemination.

Comparison to Corporate Bond Transparency Regime

This overall approach is consistent with that taken by the NASD in reviewing the appropriate treatment of high yield corporate bonds. Under the scheme for corporate bond transparency approved by the Commission, dissemination of real-time prices started with bonds of higher credit quality and issue size, which are likely to be more frequently traded and relatively more fungible with other issues. The determination of whether and how to extend dissemination to other bonds was deferred pending a determination by the NASD that such dissemination would not adversely impact the liquidity for those bonds.[4]

The NASD is now in the process of conducting that review, with the aid of its Bond Transaction Reporting Committee, half of the membership of which consists of designees of the Association. The NASD, in undertaking that review, has engaged independent economists to study TRACE data, and also is conducting dissemination on a pilot basis of 120 "BBB" rated bonds, in order to determine whether this dissemination has any discernible impact on the market for those bonds, as compared with a carefully-selected test group of similar bonds that are not subject to dissemination.

Questions to be Answered

As we stated in our August 2002 Comment Letter, we believe that the marketplace would benefit from a comprehensive review of municipal bond transparency that addresses liquidity and other key questions. Given the importance of the market and the issues that we believe must be addressed in ensuring that transparency efforts continue to benefit and not harm the market, we believe that further outreach and research by the MSRB is warranted. In particular, we believe that the following questions should be adequately answered before the current proposal is approved:

- Does the MSRB believe that transparency of bond prices on a real-time basis could have a negative impact on the market for some municipal bonds? What is the basis for its conclusion in this regard?
- In particular, has the MSRB undertaken any academic studies or conducted research on this issue? If so, what is the nature of those efforts? If not, would the MSRB be

[4] This process was specifically noted by the Commission in its approval order for TRACE as helping to strike the right balance between the need for greater transparency and concerns about liquidity impacts. Securities Exchange Act Release No. 43873, 66 FR 8131, 8134 (January 29, 2001).

willing to undertake such an effort, either separately or in conjunction with the Association or others?

We hope that these comments have been helpful and, as always, would be glad to meet with any members of the MSRB or its staff at any time to further discuss these issues. Please feel free to contact the undersigned, at 646.637.9230, or Lynnette Hotchkiss, Senior Vice President and Associate General Counsel, at 646.637.9218, with any questions...

Sincerely,

John Ramsay

John M. Ramsay
Senior Vice President
and Regulatory Counsel

cc: ***Securities and Exchange Commission***
William H. Donaldson, Chairman
Cynthia A. Glassman, Commissioner
Harvey J. Goldschmid, Commissioner
Paul S. Atkins, Commissioner
Roel C. Campos, Commissioner
Annette L. Nazareth, Director, Division of Market Regulation
Martha Mahan Haines, Director, Office of Municipal Securities

Municipal Securities Rulemaking Board
Christopher A. Taylor, Executive Director
Diane G. Klinke, General Counsel
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The Bond Market Association
Executive Committee, Municipal Securities Division
Legal Advisory Committee, Municipal Securities Division
Policy Committee, Municipal Securities Division
Price Transparency Task Force, Municipal Securities Division
Sales and Marketing Committee, Municipal Securities Division
Syndicate and Trading Committee, Municipal Securities Division
Paul Saltzman, Executive Vice President and General Counsel
John Vogt, Executive Vice President
Lynnette Hotchkiss, Senior Vice President and Associate General Counsel