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 those 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 manner, 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,

Michael Nicholas
Chief Executive Officer