

D I A M A N T

INVESTMENT CORPORATION

Comprehensive Portfolio Management

January 9, 2015

Ronald W. Smith
Corporate Secretary
MSRB
1900 Duke Street, Ste 600
Alexandria, VA 22314

RE: MSRB Notice 2014-20

Dear Mr. Smith,

Diamant Investment Corporation (Diamant) is making the below constructive comments regarding the above proposed ruling detailed in the MSRB Notice 2014-20 (Proposal). The reason for making these comments is that is after reading the text of this proposed amendment, it became clear the MSRB, a regulatory authority charged with creating rules for the municipal bond industry, has little if any understanding of the way municipal bonds trade, or of the harmful consequences such a Proposal will have for the very retail customer they are claiming to help.

The Municipal Bond Business

Diamant is a small, self-clearing, municipal bond dealer that has been in business for over 40 years serving the investment needs of retail investors. I have developed considerable expertise in the retail municipal bond business, having worked full time at Diamant, our family owned business, for over 36 years. Although the Proposal was clearly written by articulate policy makers and lawyers, I suggest they pay close attention my comments, as they are from a seasoned municipal bond investment professional who has spent an entire career working in the municipal bond marketplace.

In the fixed income marketplace, business is conducted in very large, but imperfect auction market. It is an auction marketplace that is dependent not on computer listings of bonds, but on bids and offers from a diverse group of bond dealers that position bonds for future sale. As the Securities and Exchange Commission (SEC) has described in its July 31, 2012 Report on the Municipal Securities Market, there are over 1,000,000 bond CUSIPs outstanding, with a principal amount of more than \$3.7 trillion. Note these bonds are not fungible, many CUSIPS trade infrequently, and there are different characteristics between bond issues even within the same municipality. There are complexities in locating and evaluating fixed income bonds that do not exist in other markets.

This auction market for fixed income bonds is completely different than transactions in the stock market. In the stock market, as little as 5,000 stocks trade in a manner where the same CUSIP can be traded on any given day in the year. With stocks, a customer order can be directed and executed on a listed stock exchange in a riskless agency transaction. Bonds simply do not work this way. This is all pretty basic stuff, but apparently this point was missed when someone thought it would be novel idea to effectively treat municipal bond trading just like a riskless agency transaction.

In the auction marketplace of bonds, at times Diamant is the only bond dealer in the United States that has a position in a particular bond. This bond will be offered exclusively to Diamant clients. Months may pass before this bond trades again. Diamant takes on risk of capital to buy or sell bonds for future purchase or sale. Diamant conducts a nationwide business, trading bonds in certain segments of the market it has expertise in. For many decades, customers have placed their trust in Diamant's expertise and capability to locate safe, predominantly low risk, municipal bonds for them. Bond transactions are not about moving merchandise at a discount, as occurs in a commodity type of business. Instead, bond transactions are completed by finding the appropriate investment that fits the needs and objectives of each customer. That is why a customer remains loyal to Diamant. I must point out many other bond dealers participate in this auction marketplace in a similar way.

Diamant predominantly conducts a risk business in the fixed income sector, and does not employ a sales force to sell bonds. I must admit admiration of bond dealers that have a sales force that enables the trading of bonds in the same day they are purchased. This happens when a trading desk acquires an attractively valued bond, and the sales force is immediately able to locate customers to buy this bond. It happens frequently in the bond industry, yet the tone of this Proposal is that it is now bad that salespersons are pouncing on investment opportunities for their customers.

Although it is possible certain bond dealers may have a customer order in hand and are executing it in what seems like a riskless manner, it is also possible that most trades are occurring in a normal auction place, where a trader has built a bond position in their firm inventory, and the sales force are able to quickly locate customers to purchase the bond, perhaps within a very short time frame. A short time frame does not suggest such a trade is riskless, but rather that the sales team is very good at their job of selling bonds.

Despite the use of computers and various bond listing systems, the bond industry remains a fragmented auction market place where large bond dealers, mid-size bond dealers, and small bond dealers all co-exist, with each type of firm providing strength to a part of the market place. At times when large bond dealers are unable to bid bonds, the smaller bond dealers fill the void. And with other equally savvy traders actively engaged in the markets, this auction marketplace remains surprisingly competitive in the buying and selling of bonds. Just because this industry remains an auction market does not mean the current system is broken, or needs further regulatory interference in the guise of helping the customer.

EMMA

For those who want trade information, EMMA always remains available. There is nothing wrong with the regulatory finding that EMMA is not widely used. This simply means such information is not deemed important by most customers. Yet if over time such available disclosure information has not been considered important by most customers, then there is no merit to move forward with this Proposal to further disclose this unimportant information. The underlying problem with this regulatory Proposal is there really is no problem to be solved.

Distinguishing Between Institutional and Retail Customers

In the municipal bond market, both institutional and retail investors participate in this auction market. There is no marker that distinguishes institutional from retail investors. The MSRB Proposal incorrectly assumes the existence of a specific threshold, where transactions above a 100,000 par value are all institutional customers, and trades below this threshold are all retail customers. This is a very simplistic and arbitrary threshold that does not apply in this complex marketplace. Certain retail customers may buy or sell bonds above a 100,000 par value. And certain institutional customers may buy or sell bonds below a 100,000 par value, perhaps to add or reduce an existing position. At times a retail customer may buy a bond, and the seller is an institution. At other times an institutional customer may buy a bond, and the seller is a retail customer. The important takeaway is that retail and institutional customer trades are intertwined together in the auction marketplace, and there is no bright line of a 100,000 par value to separate the two. Thus this Proposal will impact both institutional and retail investors. To use the proposed threshold of a 100,000 par value, or any other artificial device to separate or identify a reference transaction size in such a complex market, is totally inaccurate. And as there is no bona fide threshold in the market, the negative impacts to retail investors from this Proposal will also spread to institutional investors.

Recent Comments By The SEC

On page 148 of the July 31, 2012 Report on the Municipal Securities Market by the SEC, there is a recommendation that the MSRB should consider requiring disclosure to customers of any markup or markdown. This report does not require the MSRB to mandate disclosure, which is what the Proposal represents, but to simply "consider" requiring disclosure. If the MSRB left the comfort of their desks to visit and engage numerous municipal bond dealers throughout the United States as part of a listening tour to see firsthand how municipal bond trades occur, enough information would have been collected to complete the consideration of such disclosure, the consequences to the retail investor, and the industry infrastructure that runs the fixed income marketplace. Then the municipal bond industry would not be faced with such a short sighted Proposal that now lies before us.

The impetus behind this MSRB rule Proposal seems to focus on a June 20, 2014 speech that Commissioner White made where she referenced the need for markup disclosure. This speech had a laundry list of many topics. Although I admire the Commissioner, the particular topic that triggered this Proposal was not well thought out. Her intent was to probe overcharging in some trades, but I firmly believe she was looking for a way to improve, not destroy, the retail municipal bond industry. Her comments on this issue were:

"This information should help customers assess the reasonableness of their dealer's compensation and should deter overcharging. The need for markup disclosure is increasingly important as riskless principal transactions become more common in the fixed income markets."

The immediate question raised is whether overcharging is actually occurring. The MSRB has many years of data on every municipal bond trade that occurs, and FINRA conducts substantial audit work on the reasonableness of bond dealers compensation. By now it would seem reasonable to conclude that these regulators know if overcharging is commonplace. And if so, which bond dealers have a pattern of what may seem like overcharging, and what the circumstances are behind each trade.

It would seem rather straightforward to focus regulatory efforts on questionable trades and further review instances where overcharging may occur. Given the detail that went into preparing this Proposal, rest assured such statistics would have prominently displayed as overwhelming proof of this allegation and the reason for such a Proposal. Yet I have not seen news coverage on this issue for many decades. Although the topic of avoiding rampant overcharging is a noble cause, it is not an issue in the municipal bond market place.

My personal belief is it is wrong to overcharge, as the objective of this business is to provide quality bonds to valued retail clients at competitive yields so they return to buy more bonds. This simple philosophy has worked for many bond dealers like us for decades, and we really do not need a regulator to remind us of the need to take care of our customer.

Another important question raised is whether riskless principal trading is actually occurring. It is very easy to view historical data and make the arbitrary assumption that a same day trade between a dealer and a customer had no risk. However, at the point of the day when the bonds were not yet sold to a customer, the perspective of risk is different, as the bond dealer may not know for certainty whether a customer trade will occur. This introduces risk into the equation. Yet such trades are all being deemed riskless solely because it is easier for data compilation purposes. This means senior regulators are provided what may be inaccurate data from which to create policy statements that in turn attempt dramatic changes to the fixed income securities industry. It is both bad policy and dangerous to have regulators promulgate changes to an entire industry based on fundamentally inaccurate data.

A Very Bizarre Line Of Reasoning

The tone of the Proposal is that markups are somehow bad. This presumption has little to do with “helping” the customer with confusing partial disclosure. It has the feel of a politically driven effort to penalize a business sector by attempting to eliminate profits in the fixed income bond business. Which industry will be next?

There seems to be a misguided belief that securities bond dealers can continue to operate in a compliant manner in an already heavily regulated industry; can add substantive additional compliance costs to attempt to adhere to this Proposal; can continue to risk capital to provide a supply of securities to their customers; and can provide associated ongoing investment securities services to their customers; all while earning little or any gross profit. This theory simply will not work in the business world.

The reasoning behind this Proposal is that by forcing disclosure of the gross trade profit of a bond dealer, customers will somehow be better informed about the characteristics of the municipal bond investment they are making. By itself this is a very bizarre line of reasoning that is not used in any other decision making in the purchase of either small or large ticket items. To illustrate just a few examples:

When a customer purchases either a new or used car, they never see the gross profit that the car manufacturer and/or the car dealer is making, as their focus properly is on securing a piece of transportation that meets their needs.

When a customer renovates or purchases a house, they never see the gross profit of the builder or the individual seller, as their focus properly is on whether the location and structure is suited to their needs for shelter.

When a customer purchases food at their local supermarket, they never see the gross profit in each item in their cart, as their focus is on shopping in a convenient location for quality merchandise that meets their needs of nourishment.

In the municipal bond business, the retail customer needs the assistance of a professional to navigate the selection of available fixed income products. When a client buys 25,000 in bonds as in the example in Table 1, their most important decision points may include: the income stream (coupon); years until their principal is returned (maturity date); after tax return on the investment (a 3.9% yield which presumably is competitive to other similar bonds); what events can cause the principal to be returned early and what is the impact (call price and yield to call); what happens to this investment when rates move (duration); what revenue streams secure the interest payment; what assets secure the principal payment; what is the after tax return after state taxation; what other alternatives are available; whether this investment should be made now revisited at another time; and whether the bond fits into a customer portfolio. Successful fixed income investment decisions have always been made on these types of important information.

What makes this Proposal so bizarre is that the MSRB now believes customers should focus their attention not on important information described above, but instead on the disclosure of a gross trade profit number that is really not terribly relevant to the overall decision to purchase a bond. Finding out that the bond dealer in Table 1 had a gross trade profit of \$494.75 is meaningless information in a decision whether to commit ~\$25,000 to purchase a particular bond.

And if this gross trade profit appears on the confirmation that is received by the customer on or after settlement date, is the intent of this disclosure to permit customers to break trades because the gross profit was \$494.75 instead of \$394.75, or even \$294.75? If so, then any of the specific trades that meet the disclosure requirement will have to be considered as un-firm, or incomplete transactions that may have to be reversed sometime in the future. In the future, would it not be advantageous for a customer to review trades over the past six years of disclosure, select all the trades which declined in market value, and return the trades back to the bond dealer using the reasoning the gross profit was too high on the selected trades? How would a regulator expect bond dealers to haircut their net capital for incomplete trades when the dealer does not know which trades may be returned in future periods? Clearly no bond dealer would ever want to sell bonds to customers with this type of liability.

Of course the regulatory reader will counter by saying the disclosure may force the dealer to cut its gross profit and therefore the customer is better served. One would expect this perspective from regulators who apparently have not purchased a portfolio of bonds or have not worked in the industry they regulate. The gross profit is what is used to pay for all the components that keep a bond dealer in business. It is important to understand the difference between the gross profit and the net profit. Despite seeing a gross profit, it is possible there may be little net profit in a trade. Attempting to explain a gross profit on certain trades, versus a net profit, will hinge on the linguistic ability of the legal counsel of each bond dealer. With good lawyers, bond trades will become an event that results in both misleading and confusing customers over an irrelevant decision point.

In the example of Table 1, the dealer could have made a lower gross profit. The salesperson would be compensated less to communicate with their customer, the firm would not bother holding inventory it is unlikely to earn a net profit on, and the trader will not bother wasting time reviewing the marketplace. Reducing time spent on a trade and the associated customer service beyond the trade will all have to be reduced if the gross profit is the new focus of how to buy a municipal bond.

For those trades that occur with a disclosure requirement, the MSRB should expect that the customer will no longer receive the needed attention to the above critical decision points inherent in a trade, as the MSRB disclosure may reduce or eliminate the gross compensation of a dealer to provide these tasks. Then both the customer and the regulators can focus on the least relevant decision point in a transaction. In this game, the regulator now believes the trade is better for the customer, even though the customer may now own the wrong bonds without knowing it. Of course suitability comes into play, but one should not expect much effort on this beyond papering a file, as the important parts of the bond purchase decision are removed in order to display a lower gross profit. When one takes a hard look at this Proposal, it will actually harm a retail customer's ability to navigate the bond market and build a good portfolio for their hard earned money.

No Need For The Proposed Rule

In item 1 on page 13 of the Proposal, the assertion is made that the need for this Proposal is because the MSRB needs to ensure customer transactions are transacted at a fair and reasonable price. This is a stunning admission that the MSRB believes transactions are not occurring at a fair and reasonable price. If this true, then the MRSB has failed as regulator and should be disbanded.

The reality in the bond marketplace is different. The requirement to ensure customer transactions are transacted at a fair and reasonable price, pursuant to MSRB Rule G-30, has been in place for decades. Municipal bond dealers understand the rule, and make every attempt to comply with it. For many years the MSRB has received near real time trade information (15 minutes after every trade). On any given day it can review customer trades to ensure customer transactions are transacted at a fair and reasonable price.

In an imperfect auction market, where trades in a CUSIP may occur at different prices during the day, trades will happen at differing prices for differing quantity sizes, that may be higher or lower than other trades. To the extent the trade price seems way out of line, an outlier, one would presume the MSRB would have a mechanism in place to request further information on the trade. Presumably a regulator who is familiar with the working of the industry it regulates would be in a position to understand the level of effort a firm went through to complete a particular trade, or understand when a firm has no justification of what may be a pattern of outlier trades. This is what regulatory oversight is in the securities industry.

It is very misleading for the MSRB to allege that after decades of regulatory oversight, that it now believes the entire municipal bond industry is not effecting customer transactions at a fair and reasonable price, which therefore justifies the need for this Proposal. In my experience with decades of very comprehensive audits from regulatory examiners, it would be difficult for a municipal bond firm to remain in business if their intent was to transact their business in a manner other than to comply with MSRB Rule-30.

Evaluate The Market For Securities

In item 1 on page 13 of the Proposal, the MSRB now believes customers may not be able to evaluate the market for their securities. The only way one can make assertion is to assume that all retail customers are stupid, as they must have absolutely no idea what is going on in the world. And that those types of customers will finally be able to evaluate the municipal bond marketplace by knowing what the gross profit was on some confirmations.

In the last four decades in this industry, I have yet to meet a stupid customer. Every customer I have dealt with understands much more than the MSRB gives them credit for. Whether having a high school education or a doctorate degree, they all display good judgment, and they appreciate assistance in navigating the municipal bond marketplace. Most important, the current confirmation disclosure rules provide a sufficient description of exactly what they are buying.

Also, like many other bond dealers, Diamant provides customers with periodic portfolio appraisals that use an independent pricing source that illustrates the market for each of their securities. So when making the assertion that customers are unable to evaluate the market and therefore would benefit from more regulation and disclosure, the MSRB is simply insulting the intelligence of retail customers.

While the MSRB is questioning whether customers may not be able to evaluate the market for their securities, why stop with municipal bonds? In today's security marketplace, customers may not be able to evaluate the market for any of their securities or other investments.

Start with stocks. What makes a regulator think the price paid for a stock properly reflects the market for this security? High volume traders now dominate the trading activity, with their computers moving stock prices based on the parsing of text in the news flow. Customers do not actually know company sales and earnings when reviewing a company between earning releases. Recent price moves may not reflect earnings potential. And institutional investors may have access to better information than retail investors. Shouldn't there be a much greater concern by regulators of whether customers are able to evaluate the market for any of their stocks?

What about investments in annuities? What makes a regulator think the price paid for an annuity properly reflects the market for this security? Customers do not actually know how their complex annuity investment will work in the future. And they may have purchased this tax deferred investment within a tax sheltered vehicle such as their IRA, making the tax deferred benefit very difficult to understand. Shouldn't there be a much greater concern by regulators of whether customers are able to evaluate the market for any of their annuities?

What about investments in commodities such as oil? What about the price of home heating oil? Or the price of gasoline paid to drive a car? What makes a regulator think the price paid for any oil based commodity properly reflects the current market for this security? Customers do not actually know the real prices for a commodity when reviewing such purchases. Recent price moves may not reflect the underlying markets. Shouldn't there be a much greater concern by regulators of whether

customers are able to evaluate the market for any of their commodity related purchases, such as their gasoline and home heating oil?

In the United States, individuals are making reasonable decisions every day without being able to conduct a complete evaluation of every facet of information that may or may not pertain to their decision. This applies to securities investments, as well as every other economic decision they need to make. The fact that transactions continue to occur suggest that customers are able to evaluate the market using existing information for their securities. Thus another underlying premise of this Proposal, of customers now being unable to evaluate the market for their securities, is incorrect.

Unintended Consequences

Any securities firm forced to report gross markups on some bond trade confirmations will certainly harm their customer relationships. The anger and confusion from retail customers' who receive this partial information on some bond trades but not others, without understanding how the fixed income auction market works, or the level of effort that went into the locating and acquisition of a specific bond, will boil over throughout the municipal bond industry. Human nature being what it is; customers will consider any markup number disclosed pursuant to this Proposal to be too large. Everyone should expect customers who are given disclosure of a gross profit number on a trade to be upset the number is not smaller.

Before the regulatory reader gets a smug sense of satisfaction, one needs to understand what happens next. If a confirmation disclosure from a municipal bond transaction is perceived to harm a customer relationship, most securities bond dealers will simply stop trading municipal bonds. Wall Street is full of smart people who will find some other way to service their customers tax exempt income needs without dealing in specific municipal bonds.

It is laughable to think that the effect of this Proposal will be to enhance competition between bond dealers. Most bond dealers enjoy their own client base that has been cultivated over time. Because of the complexities of buying bonds which are not fungible and may not available at other bond dealers, these purchases are not shopped between bond dealers. Each firm provides an investment experience that its clients seek, at a service level which may differ from other bond dealers. Under this Proposal, a low volume firm with a small sales force will likely have few, if any, disclosures to make on their confirmations, as they may not trade the same CUSIP within a day. Bond dealers with high trading volumes may trade the same CUSIP within a day, and will have disclosures on many of their confirmations. Thus some bond dealers are forced to disclose, while others are not. From a pure economic perspective, the firm making disclosures is at a competitive disadvantage to the firm that does not need to make disclosures.

Under this perspective, a firm like Diamant would benefit from this Proposal. Yet the municipal bond business is such that Diamant also needs other bond dealers, both large and small, to remain viable in order for the auction marketplace to work. Therefore Diamant is opposed to this type of regulatory interference that places another bond dealer at an artificial competitive disadvantage to another.

Given retail trading represents nearly 70% of the trades in the municipal bond business, the cessation of retail trading in response to this MSRB Proposal will destroy the market for retail trades in municipal bonds. And as many small and mid sized municipal bond dealers are active in niche sectors within this retail market, they will be greatly harmed regardless whether the disclosure Proposal even applies to their type of business.

Even though this disclosure requirement would not apply, Diamant would be part of the collateral damage as the marketplace stops functioning without the inclusion of other bond dealers with retail clients. And this avalanche of unintended consequences creates a major liquidity problem for retail investors who need to either buy or sell municipal bonds as bond dealers exit the bond business.

How To Harm Retail Customers And Damage The Municipal Bond Industry Infrastructure

The best way for the MSRB to harm retail customers and damage the municipal bond industry infrastructure is to proceed exactly with this Proposal. The MSRB will celebrate achieving disclosure not seen in other industries, and then will wonder why the bond dealer community stopped handling retail customer trades. What a brilliant disaster.

How can the retail customer be harmed with this disclosure? First of all, municipal bonds will stop trading at many if not all bond dealers. Why would any bond dealer want to effect trades that antagonize their relationship with their customer, and create unknown liabilities of future trade cancellations, regardless whether such trades provide great value to their clients? If this Proposal is implemented, my immediate response will be to prohibit trading any municipal bonds from or to retail customers, for any bond that meets the disclosure definition under this Proposal. Not only would customer relationships be harmed, but the additional compliance costs would be excessive for just these specific types of trades. Many other bond dealers may arrive at the same conclusion. The harm is that the retail investor will be denied liquidity in what remains of the municipal bond marketplace.

Secondly, many entrepreneurial bond dealers like Diamant, are a part of the municipal bond auction marketplace that will become part of collateral damage from this proposed ruling. I take great offense that the MSRB is acknowledging the destruction of capitalism in the bond marketplace, by accepting the collateral damage to many bond dealers and brokers. In the section of the Proposal titled "Effect on Competition, Efficiency and Capital Formation", the MSRB proclaims the likely effect is competition between bond dealers will be enhanced. Yet in the very next paragraph the MSRB contradicts itself by acknowledging the costs could lead small bond dealers to exit the market. Somehow there is supposed to be more competition with fewer industry participants. This makes no sense.

Third, it is hard to imagine that this Proposal will achieve fair and reasonable prices for any customer after this collateral damage occurs. Bond dealers collectively provide necessary components to the maintenance of liquid markets. Our absence will harm retail, institutional investors, and any remaining bond dealers. It is important to remind the MSRB that the complex fixed income marketplace does not and cannot operate on some computer program. It runs on the efforts of numerous talented individuals employed at numerous bond dealers, without whom the market simply stops. I have been around long enough to see a temporary stop in municipal bond trading, and it is frightening.

Fourth, from an operational perspective, the MSRB must understand that bond dealers are unable to comply with identifying reference transactions without incurring substantial costs to back office operations. It will be easier to create a firm wide immediate stop trading system on a CUSIP before or just after a retail customer trade occurs, than to monitor all trade volume before or after the retail trade occurs. Even if a firm does not expect to have to make disclosure, they will have to have both a back office and compliance system in place to identify transactions that meet this Proposal and then process such trades in a manner completely different than other trades. Who thought this was a good idea?

It is completely naive to think that every firm just waves a magic wand to achieve instant compliance with a rule that will be very difficult to comply with, even at a low volume dealer. Compliance costs will be very significant to create a separate purchase and sales module to existing back office systems to identify applicable trades and then create a substantive, unique disclosure document on selected confirmations. This process will delay the sending of such trade confirmations as there will have to be a completeness check on all impacted confirmations prior to mailing, and an internal audit function to assure that every bond transaction that meets certain eligibility is part of this exception processing. These additional processes and reviews will likely delay the batch production and mailing of all securities confirmations for that trade date until the broker dealer is confident the confirms that need disclosure have been properly prepared.

As this has never been done before, we do not have a hard data processing quoted cost to achieve this. If we were to create a new automated separate purchase and sales module to integrate within our legacy back office system, we would likely have to start with a budget at \$100,000. For our size firm, it would take several years of diverting trading all net profits from municipal bonds to cover this cost. As this is an unworkable solution, the person who ultimately must pay for the additional per trade compliance costs for this Proposal is the customer. This additional cost will have to be added to each transaction. Most clairvoyant readers will understand the increased operational and compliance costs added to each transaction actually is harming the very customer this Proposal is claiming to "help".

Alternatives To This Absurd Proposal #1- Internal Regulatory Rules

If the MSRB is fixated on bond reference disclosure, then let the bond dealers create their own sets of rules on how to handle trading in manner that avoids all disclosure. The way to achieve this is to make sure the bond dealer only completes one principal trade to a retail client in any particular CUSIP for any particular trading day. Should a firm trade a CUSIP in the morning to a retail client, they would have to stop bidding or trading this bond throughout the remainder of the day. Conversely, if that CUSIP had traded somewhere else in their firm during that day, the firm would also need to modify its systems to refuse to sell these bonds to a customer by creating an internal stop trading system. In this manner, even though the customer may want to purchase a particular bond which really fits the customer's investment needs, they may not be able to buy the bond due to a regulatory time delay. And if a customer needs to raise cash immediately, in this environment they will have to understand there is now a regulatory time delay in their sale. This regulatory time delay is the direct result of such a naive Proposal, but it is a workable solution for the dealer community.

Aside from a regulatory time delay, what happens to the auction marketplace as bond dealers create their own sets of trading rules to comply with this Proposal? After this Proposal is implemented, the last thing a bond dealer will want is to inadvertently buy bonds in the same day a customer purchased bonds. So bond dealers will need to change all their Street bids as being subject to being pulled at any time. Instead of firm bids that are good for the day, municipal bond brokers and other participants (such as bond dealers representing other retail and institutional customers) will be working with un-firm bids from the Street that really just are indications of where bond dealers might want to buy a bond if no other trades occur in the bond that day at their firm.

With un-firm bids, the auction market in municipal bonds ceases to function properly. As an illustration of un-firm markets, I will always remember how the stock market quotes were un-firm when the equity markets were having difficulty functioning during the stock exchange market crashes of 1987, 1998, 2002, and 2008. One does not need a vivid imagination to understand what happens in an auction marketplace when rates move and the bidding bond dealers who understand the bonds refrain from bidding due to this new rule. Large, ten point spreads would be commonplace, assuming a bona fide bid materializes. This substantial market impact will be a direct result of this Proposal.

Alternatives To This Absurd Proposal #2- Time Period

If the MSRB has already decided to proceed with this Proposal prior to reading industry comment letters, then modify the time period for disclosure between offsetting trades in a CUSIP to be within 15 minutes of the first trade. This will enable back office operations to identify adjacent trades that would need disclosure, while permitting municipal bond dealers to continue to operate in the marketplace during the rest of the day without triggering inadvertent disclosure. Moreover, back office enhancements can be designed in a much more cost effective manner if they focus on adjacent transactions within 15 minutes instead of the entire trading day. In this scenario, bond dealers may actually be able to afford the additional compliance costs. As important, the reference trade can be identified and then reported in the same 15 minute time frame using the same system as RTRS. This will provide near real time reporting of “riskless” trades for regulatory review, and provide for accurate manual procedures of identifying in back office operations the specific confirmations that need special handling and processing.

Alternatives To This Absurd Proposal #3 - Exclusions

If the MSRB has already decided to proceed with this Proposal prior to reading industry comment letters, it would be prudent to include exclusions for certain types of transactions notwithstanding the fact they are retail sized transactions. In addition to excluding institutional investors, the Proposal should also exclude entities that act with institutional type knowledge. This should include banks, trust companies, and registered investment advisors that are employed by individual and institutional customers to invest their portfolios and make transaction decisions on behalf of their customers.

Alternatives To This Absurd Proposal #4- Listed Exchange

Maybe the real intent of the MSRB, under the guise of selected confirmation disclosures, is to completely change the marketplace which it regulates. If so, then instead of half measures like this Proposal, perhaps the MSRB should complete the destruction of the auction marketplace as we know it. There may be no further need of having skilled trading professionals at numerous bond dealers acting as an auction marketplace. Instead the MSRB could mandate to change the entire municipal bond business from an auction marketplace to one where the MSRB acts as a listed exchange to simultaneously make the entire market for over 1,000,000 different CUSIPS. This would be reminiscent of the New York Bond Exchange back in the 1980's, that had occasional markets, in some corporate bonds, with bid and ask sizes of around 2,000 to 3,000 in face value. But in this case the MSRB would create a riskless marketplace that would always maintain deep markets for all CUSIPS, of at least 100,000 par value in both bid and ask sizes.

Because the market would now be riskless with only one exchange controlling the entire market, pricing efficiencies would be attained. All market participants would expect very small spreads between bid and ask from the MSRB listed exchange, perhaps as little as a tenth of a basis point. To achieve this grandeur, the MSRB would simply have to initially commit several trillion dollars of their capital in order to maintain sufficient market depth in every bond CUSIPS that come to their marketplace.

This way our municipal bond industry would remove capitalism from the marketplace and let the government regulators make the entire market. In this concept, bond dealers would be able to always sell blocks of bonds to the MSRB listed exchange at the market. Most importantly, when yields move higher, the same bond dealers then would be able to buy these blocks of bonds back as the MSRB computer algorithms would of course have marked down the positions to reflect much lower market prices.

This concept would create the riskless market to participants that the MSRB currently believes exists. This fantasyland type of idea would be a boon to the municipal bond dealers as they could remove the market risk from their inventory positions. And by permitting bond dealers to establish either short or long positions on bonds traded on the MSRB listed exchange, they could profitably employ traders. Also the customers would enjoy riskless trading, as long as the MSRB listed exchange, as a systemically important financial institution, continues to engage in this non-profit business without filing for bankruptcy.

This scenario is the alternative to an auction marketplace. When the Proposal destroys the auction market place, the MSRB should have a plan in place similar to this one to avoid harming the retail customer while maintaining liquidity for the remaining participants.

Alternatives To This Absurd Proposal #5- No Action

After reviewing the Proposal and alternatives, the MSRB needs to recognize this Proposal will do more harm than any good. The disclosures will clearly mislead and confuse retail investors to a degree that cannot be remedied by education, explanations, or descriptive documents accompanying a confirmation.

The auction marketplace has many intertwined industry participants that include retail customers; institutional customers; large municipal bond dealers; mid-size municipal bond dealers; smaller municipal bond dealers; municipal bond dealers that trade mainly with other municipal bond dealers; municipal bond dealers that trade mainly with their customers; and bond brokers that facilitate trades between all types of municipal bond dealers. All these participants within this very large auction market will be adversely impacted. The noteworthy harm will occur to retail customers that will be unable to trade bonds on days that their bond dealer decides not to trade their CUSIP, in order to avoid disclosure of this Proposal. The larger harm will come from the auction marketplace no longer having liquidity. This occurs from the absence of firm bids as bond dealers stop trading bonds that would trigger the disclosure in this Proposal. These are terrible, yet very realistic outcomes from this Proposal.

Harming the relationship between the customer and the bond dealer, and having bond dealers reduce or eliminate retail trades, all for the sake of this misguided Proposal, simply does not add any benefit to the retail customer.

In this reasonable alternative, the MSRB must simply recognize the complexity within the entire fixed income marketplace, review the alternatives, and commit to taking no action on the entire Proposal.

Conclusion

While on the very surface the Proposal seems a noble idea, as shown throughout my response, it actually opens up a Pandora's Box that is uncontrollable in terms of damage to the fixed income auction markets. Moreover, the Proposal is trying to solve problems that do not exist. Most customers are being treated fairly by the markets. So there is no reason to run a regulatory wrecking ball through a working auction marketplace in a manner that destroys capitalism, impairs retail customer access to markets, and impairs or shuts down bond firms. The conclusion must be that the MSRB thoroughly reviewed the matter in a meaningful way, but after careful consideration of the unintended collateral damage to the marketplace, decided to take no action in order to continue maintaining an orderly and regulatory compliant market in municipal bonds.

Yours truly,



Herbert Diamant
President