

March 21, 2014

Ronald W. Smith, Corporate Secretary
Municipal Securities Rulemaking Board

Re: MSRB Notice 2014-02

Mr. Smith:

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

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

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

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

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

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

Sincerely,

Chris Melton
Executive Vice President
Coastal Securities