



September 11, 2009

Peg Henry, Esquire  
Associate General Counsel  
Municipal Securities Rulemaking Board  
1900 Duke Street, Suite 600  
Alexandria, VA 22314

Re: MSRB Notice 2009-47: Request for Comment Regarding Priority of Orders in Primary Offerings

Dear Ms. Henry:

The Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> appreciates this opportunity to respond to Notice 2009-47<sup>2</sup> (“Notice”) issued by the Municipal Securities Rulemaking Board (“MSRB”) on proposed amendments to Rule G-11 on new issue syndicate practices, Rule G-8 on books and records and Rule G-9 on preservation of records.

#### Introduction

The MSRB is responding to the concerns of institutional investors, whose orders are not filled in whole or in part during a primary offering and, soon thereafter, see those same bonds become available in the secondary market at higher prices. The two causes cited by these investors in the Notice are: (i) retail dealers that place phantom orders during a retail sales period; and (ii) syndicate members, their affiliates and their related accounts that purchase bonds for their own account while other orders remain unfilled.

The solution proposed in the Notice is threefold; it would: (i) require that, unless otherwise agreed to by an issuer, the syndicate managers give priority to customer orders over orders for their own account, orders from an affiliate for its own account or orders for their

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<sup>1</sup> The Association, or “SIFMA,” brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA’s mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public’s trust and confidence in the markets and the industry. SIFMA works to represent its members’ interests locally and globally. It has offices in New York, Washington D.C. and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

<sup>2</sup> MSRB Notice 2009-47 (August 11, 2009)

respective related accounts; (ii) expand the ambit of Rule G-11 to include all primary offerings (and not only syndicated transactions); and (iii) add new definitions for the terms “affiliate” and “related account.”

Given SIFMA’s efforts to enhance the public’s trust and confidence in the municipal securities market, we are sympathetic to investors whose orders are not fulfilled. To that end, SIFMA supports the Notice of Interpretation Concerning Priority for Orders in a Primary Offering: Rule G-17 (“Interpretive Notice”). We do not, however, support the proposed amendments in the Notice as they would disrupt the process of allocating securities as discussed in greater detail below.

#### Unfilled Orders

As a threshold matter, the allocation of municipal securities or any other securities in an original issuance is a zero sum game governed by the principles of supply and demand. Consequently, when securities with a value in the marketplace are sold, there will always be frustrated potential investors whose orders are not filled.

The Notice insinuates that syndicate members are responsible for placing phantom retail orders and front running and then selling the securities in the secondary market for a profit to the detriment of institutional investors. The MSRB’s response is to propose a solution directed solely at syndicate members, their affiliates and related accounts.

Placing phantom orders and front running may contribute to this situation, but they are not the sole contributing factors. In reality, unfilled orders and the sale of bonds in the secondary market at a profit often result from legitimate actions taken by those who are not syndicate members. In SIFMA’s view, the proposed amendments would not prevent these activities but, instead, would impede the ability of syndicate members to distribute securities in an orderly fashion.

An institutional investor’s order may not be filled because, for example, its broker is a member of the syndicate but received a small allocation of securities, the price it offers for the securities is not competitive with the offers of other investors, the tranches of the securities it wants to purchase may not fit in with the overall plan of distribution, it wants to purchase non-callable bonds that the issuer does not want to sell, it cannot compete with the balance sheet of professional managers and hedge funds, the issuer has an extended retail order period that limits the allocations to institutional investors or a combination of these reasons. None of these activities, however, would be prohibited by the proposed amendments.

## Securities in the Secondary Market

Just as market forces not related to syndicate members can result in an investor's unfilled order, market participants other than syndicate members may offer their securities in the secondary market for a profit. Such sellers can include any municipal market participant - retail customers as well as institutional accounts. Municipal securities are not restricted securities and are not subject to any minimum hold periods. It should go without saying, that once a syndicate member sells a security to any customer, the seller does not have any responsibility for the actions taken by the purchaser. As a result, creating a solution that is focused only on syndicate members, their affiliates and related accounts does not address the concerns contained in the Notice.

## Front Running and Placing Phantom Orders are Already Illegal Activities

If the intention of the proposed amendments is to prevent front running and placing phantom orders, it is difficult to see what is added by the proposed amendments because both activities are already prohibited under MSRB Rule G-17, which applies to all broker dealers regardless of their status in the syndicate. Moreover, under the current regulatory requirements, broker dealers retain records of orders, allotments, trade reporting data and trade confirmations, which are used by Financial Industry Regulatory Authority ("FINRA") to audit enforcement with Rule G-17. SIFMA urges FINRA to vigorously enforce existing laws and regulations to prevent front running, placing phantom orders and all other deceptive, dishonest or unfair practices.

## The Proposed Amendments

Not only would the proposed amendments not accomplish the goals stated in the Notice, they would also have several detrimental effects on the process of allocating securities.

### *Increased Borrowing Costs*

If enacted, the proposed amendments would isolate a very large group of active municipal market investors and, because they are affiliated with or related to the syndicate manager, subordinate them to other investors. In creating a tier of second class investors, the proposed amendments would significantly decrease the number of buyers and reduce competition for securities, which could result in issuers paying higher borrowing costs. We are certain that it is not the intention of the proposed amendments to create a regulatory preference in the allocation of securities that would unfairly favor investors at the expense of issuers.

### *Contravention of Rule G-11*

The proposed amendment would also contravene the intention of Rule G-11. The MSRB is well aware that the allocation of securities involves a balance of competing interests. Syndicate managers must balance the needs of their issuer clients to get the widest possible distribution of securities at the lowest borrowing cost with the demands of their many investor clients for securities. Syndicate managers must also balance the needs of their various investor clients, all of whom want their orders filled. Because of the tension among these factors, the current Rule G-11 provides discretion to syndicate managers, who may include a provision in the priority provisions allowing them, on a case-by-case basis, to allocate securities in a manner that is different from the priority provisions if doing so would be “in the best interests of the syndicate...” This discretion, however, is coupled with accountability (impliedly, to the issuer and regulators): when an allocation is made that is not in accordance with the priority provisions, “the syndicate manager...shall have the burden of justifying that such allocation was in the best interests of the syndicate.”

Even though the proposed amendments include the phrases, “Unless otherwise agreed to with the issuer” and “to the extent feasible and consistent with the orderly distribution of securities in the offering,” if enacted, they would, nonetheless, interfere with the discretion granted to syndicate members by requiring them to comply with the regulatory priority.

### *A Failure to Harmonize Regulation*

The proposed amendments also represent a lost opportunity to increase regulatory harmony between the MSRB and FINRA rulebooks. The Notice was published one week after FINRA published Regulatory Notice 09-45 that was intended to simplify the rules regarding corporate fixed price offerings. One of the most important proposals of Regulatory Notice 09-45 would permit a member of a selling syndicate to sell fixed price securities to an affiliated person, provided, that the sale was not at a discount, thus creating a regulatory model that is the exact opposite of the MSRB’s proposed amendments.

In this era of regulatory reform, one of the most often repeated goals is to achieve regulatory harmonization wherever possible. Such cooperation, of course, would minimize the confusion and burdens that result from separate regulatory schemes. From our perspective, it would appear that the rules pertaining to the allocation of municipal securities and fixed price offerings would be fertile ground for such harmonization. If, enacted, though, the proposed amendments would require divergent enforcement by FINRA of similar instruments sold in different markets.

## The Interpretive Notice

In SIFMA's view, the Interpretive Notice is a balanced and reasonable application of the fair play principles of Rule G-17 to the allocation of securities, without mandating priorities. The Interpretive Notice recognizes that syndicate managers should give priority to customers while taking into account the need for flexibility. For example, the Interpretive Notice states:

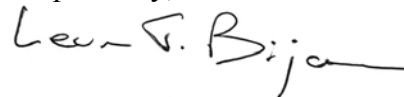
Principles of fair dealing *generally* will require the syndicate manager to give priority to customer orders over orders for its own account, orders by other members of the syndicate for their own accounts, orders from persons controlling, controlled by or under common control with any syndicate member ("affiliates") for their own accounts, or orders for their respective related accounts...*to the extent feasible and consistent with the orderly distribution of securities in a primary offering* (emphasis added).

## Conclusion

For all the reasons cited in this letter, SIFMA supports the Interpretive Notice, which applies the principles of Rule G-17 to the priority of orders in allocating securities but SIFMA does not support the proposed amendments in the Notice.

We appreciate this opportunity to comment on this proposed rule change. If you have any questions concerning these comments, please contact me at 212.313.1149 or at [lbijou@sifma.org](mailto:lbijou@sifma.org).

Respectfully,



Leon J. Bijou  
Managing Director  
and Associate General Counsel

cc: ***Securities Industry and Financial Markets Association***

Municipal Executive Committee  
Municipal Legal Advisory Committee  
Municipal Credit, Research, Strategy and Analysis Committee  
Municipal Syndicate & Trading Committee  
Municipal Operations Committee  
Regional Dealers Fixed Income Committee