

June 5, 2008

Catherine A. Courtney
Assistant General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street
Suite 600
Alexandria, Virginia 22314

Re: MSRB Notice 2008-19: Proposal for Proprietary Desk Transactions to be
Reported as Customer Transactions under MSRB Rule G-14

Dear Ms. Courtney:

The Securities Industry and Financial Markets Association (“Association”)¹ appreciates this opportunity to respond to Notice 2008-19 issued by the Municipal Securities Rulemaking Board (“MSRB”) on April 11, 2008 (“Notice”) in which the MSRB requests comments on its proposal to require proprietary desk transactions to be reported to the MSRB’s Real-Time Transaction Reporting System (RTRS) as customer transactions. The Notice summarizes current practices that generally consider, (i) internal movements of municipal securities within a firm as not reportable under Rule G-14 because there is no change in ownership, and (ii) external transactions as inter-dealer trades. The proposed rule change would treat both internal and external transactions with the proprietary desk as reportable customer transactions. The Notice further states that the RTRS serves the dual role of providing real-time transaction price transparency to the marketplace, as well as supporting market surveillance by the enforcement agencies.

The Association recognizes that the purpose of the proposed rule change is to achieve consistency in RTRS price reporting for internal and external transactions with proprietary desks. However, the Association has concluded the proposal would create new inconsistencies and would result in interpretive issues involving the treatment of the proprietary desk as a customer that would produce significant problems of implementation. We also do not believe the proposal would further the dual objectives of RTRS as stated above.

¹ 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.

An important characteristic of fixed income departments is that there are routine flows of securities internally among desks without change in legal ownership of the securities. A proprietary desk is only one site at which securities may be located, and (in response to the Notice's third question) these internal transactions are generally treated on the dealer's books and records as a transfer from one inventory account to another inventory account. The fact that there is no change in legal ownership, and the accounting is similar for various flows of securities, suggests that a proprietary desk should not be singled-out for unique treatment in contrast to, for example, the derivatives desk. Separating one desk from others in the flow, and treating it as though it were an external customer, would result in internal inconsistencies and interfere with the current straightforward approach based on legal ownership. It should be noted that the Financial Industry Regulatory Authority (FINRA) rules for price reporting have not attempted to make distinctions in the location in the internal flow of fixed income securities as an event triggering price reporting. On the FINRA website, there are responses to frequently asked questions, including the following:

In moving a TRACE-eligible bond from one firm principal trading account to another, is a member firm required to submit a TRACE report, or is this simply an inter-company transfer?

If there is no change in ownership it is merely a journal entry between accounts and is not reportable to TRACE.²

The operational issues derive, in part, from the difficulty in clearly identifying a desk as a proprietary desk in a municipal securities department. In response to the Notice's first question, it is customary for dealers to establish informational barriers between trading and proprietary desks, and (in response to the Notice's second question) to conduct transactions between the trading desk and the proprietary desk on an arms-length basis. However, the "either-or" quality of these two questions in the Notice fails to account for important characteristics in the organization of a municipal securities department. In 2002-2003, when there were reforms to prevent research analyst conflicts, which required firms to erect internal barriers, it was recognized that there were important differences between equity and fixed income research that affected the need for barriers. As a consequence, the rigid barriers for equity departments were not applied to fixed income departments, and the importance of some overlays between the trading desk and fixed income research was recognized.³ Similarly, the separation between proprietary functions and trading is more situational and based on circumstances rather than on legal boundaries. It follows that there is not an explicit identification of a

² www.finra.org/RegulatorySystems/TRACE/FrequentlyAskedQuestions/Reporting.

³ The Bond Market Association, *Guiding Principles to Promote the Integrity of Fixed Income Research: A Global Approach to Managing Potential Conflicts of Interest* (May 2004).

proprietary desk based on conflict rules, and several desks that trade on behalf of the firm using firm capital have proprietary characteristics. Different firms may consider different desks as proprietary, and, if the MSRB proposal were adopted, there would not be a functional consistency among firms regarding the desk that would be considered a “customer.”

The preceding suggests that it would be difficult to identify a desk that should be treated as an internal customer in a manner that would apply a clear policy objective among firms. Internal desks are customers in various ways, but if a particular desk were formally identified as a “customer” under Rule G-14, there would be further implications under the MSRB rules. Throughout the MSRB rules there is a basic distinction made separating a dealer’s obligation to customers and a dealer’s obligation to other dealers. The Notice does not suggest any customer rules are to apply to the proprietary desk other than price reporting. Nevertheless, MSRB Rule D-9 defines a “customer” as any person other than a dealer “acting in its capacity as such.” There would have to be clarification that the proprietary desk would not be treated as a customer within this definition, because the effect of the proprietary desk being a Rule D-9 customer would carry over to many MSRB rules, from suitability, to fair dealing to mark-up policies, etc., and all the record-keeping under Rule G-8 applicable to customers. On the other hand, if a proprietary desk were clearly defined as a customer for one MSRB rule, it is difficult to make a reasoned argument that certain of the customer protection rules should not apply. A preferable approach is the current practice of applying “customer-like” rules in varying circumstances without introducing a formal definition.

The Notice appears to recognize the difficulties that arise as the result of the introduction of an “internal” customer in the fifth question that requests comment on how proprietary desk transactions should be separately identifiable from “external” customer trades in order not to run afoul of the Rule G-17 interpretation giving such customers priority in new issue allocations. The MSRB’s 1987 guidance⁴ provides that fair dealing principles require that allocations of new issue securities give customer orders priority over “similar dealer or certain dealer-related account orders” to the extent feasible. A footnote defines a “dealer-related account” to include “a municipal securities investment portfolio, arbitrage account or secondary trading account of a syndicate member, or an accumulation account established in connection with such municipal securities investment trust.” This issue illustrates the general problem to be resolved in determining whether a proprietary desk would be treated as a customer throughout the MSRB rules or solely for purposes of price reporting.

Carving out one type of trade within the internal flow of securities for price reporting does little or nothing to promote the dual objectives of RTRS, transparency and support of market surveillance. The relevant times for providing transparency are, (i) the

⁴ MSRB Notice of Interpretation Concerning Priority of Orders for New Issue Securities: Rule G-17 (Dec. 22, 1987).

time at which a municipal security enters the firm and (ii) the time at which it leaves the firm. Current Rule G-14 requires real-time price reporting at these events. The flow within a firm is within a single legal entity, and the pricing in a transfer from one internal inventory account to another does not provide the market with meaningful information. Likewise, for purposes of surveillance, the municipal security is within a single legal entity, and locating it at a particular desk that has certain proprietary features does little to promote surveillance when it is recognized that the security could be at another desk with some proprietary features that happen not to be within an arbitrary definition of an “internal customer.”

There are also issues that would have to be resolved in changing an external trade from an inter-dealer transaction to a customer transaction. If the proprietary desk is not treated as a dealer, the proprietary desk as customer may require a dealer to effect the transaction on its side. This possibility raises the likelihood of a “step out” transaction if deliveries of securities occur between two dealers, although the two dealers have not effected a purchase-sale transaction with each other.⁵ The dealers would presumably use the comparison system for matching only, but there would not be an inter-dealer trade report. Trade reporting would be on a one-sided customer report. The Association believes the current system of treating a trade that comes into the firm, whether to a trading desk or some type of proprietary desk, is more properly considered an inter-dealer transaction.

Finally, there are many operational issues implicit in the MSRB’s proposed rule change. The changes in price reporting are obvious, and the operational issues become more difficult in distinguishing an “internal” from an “external” customer for accounting, Rule G-8 recordkeeping and general compliance with MSRB rules. As indicated in the preceding discussion, it is highly difficult, as a conceptual matter, to identify a particular desk as “the” proprietary desk for purposes of determining the site of the firm’s “internal” customer to comply with the rule. The problem is magnified when viewed as an operational, technical programming requirement that would intervene at one point in the internal flow of municipal securities to trigger an arbitrary report of the internal price computation. The operational issues should be considered in light of the statutory requirement of section 19 of the Securities Exchange Act of 1934 that provides a rule change is not to be approved if it unduly burdens efficiency. When the absence of any clear furtherance of the dual objectives of RTRS is compared to the operational difficulty of implementing the proposal, it is apparent that no change should be made.

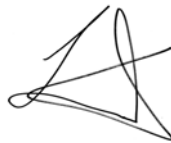
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See MSRB Notice 2005-22 (April 1, 2005).

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If you determine to proceed with the proposed rule change described in the Notice, we respectfully request that you meet with a group, such as SIFMA, representing several firms to discuss how a proprietary desk in a municipal securities department would be identified. We appreciate this opportunity to comment on the proposal. If you have any questions concerning these comments, or would like to discuss these comments further, please feel free to contact the undersigned at 212.313.1130 or via email at lnorwood@sifma.org.

Respectfully,

A handwritten signature in black ink, appearing to be 'L. Norwood', written over a faint, stylized triangular graphic.

Leslie M. Norwood
Managing Director and
Associate General Counsel

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cc: ***Securities Industry and Financial Markets Association***
Municipal Executive Committee
Municipal Legal Advisory Committee
Municipal Operations Committee
Municipal Syndicate & Trading Committee