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September 15, 2006

Mr. Justin Pica
Uniform Practice Specialist
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

RE: MSRB Notice 2006-20: Draft Procedures for Reporting Special Condition Indicators for Certain Special Trading Situations

Dear Mr. Pica,

The Bond Market Association ("Association")¹ appreciates this opportunity to respond to the notice ("Notice") issued by the Municipal Securities Rulemaking Board ("MSRB") on July 31, 2006² in which the MSRB requests comment on draft procedures for reporting special condition indicators for certain special trading situations of transactions reported to the MSRB's Real-time Transaction Reporting System ("RTRS"). The stated intent of the proposal was to: (i) clarify transaction reporting requirements and require use of the existing "away from market" special condition indicator on trade reports of four types of transactions typically executed at special prices; (ii) create two new special condition indicators for purposes of reporting certain inter-dealer transactions "late"; and (iii) provide an end-of-day exception from real-time transaction reporting for trade reports identified as "away from market." The stated purposes of the MSRB's transaction reporting program for municipal securities are to serve the dual roles of providing price transparency and supporting market surveillance.³ Many of the proposed changes below would create issues such as the double-counting of trades, reporting of trades which occur at an off-market price by design and the reporting of variable rate and auction rate securities which necessarily trade at par. These proposed changes do not enhance the

¹ The Association is a trade association that represents approximately 200 securities firms, banks and asset managers that underwrite, trade and invest in fixed-income securities in the United States and in international markets. Fixed income securities include U.S. government and federal agency securities, municipal bonds, corporate bonds, mortgage-backed and asset-backed securities, money market instruments and funding instruments such as repurchase agreements. More information about the Association and its members and activities is available on its website www.bondmarkets.com. The Association is expected to merge with the Securities Industry Association in November 2006. More information about the SIA and its members and activities is available on its website www.sia.com.

² MSRB Notice 2006-20.

³ MSRB Notice 2003-23.

stated goals of the MSRB's transaction reporting system by increasing price transparency. Additionally, the audit and surveillance of these transactions and related transfers of securities have been adequately handled by the current examination processes of the regulators.

1. *Transactions Executed with Special Pricing Conditions*

Many of the proposed changes to the Specifications for Real-time Reporting of Municipal Securities Transactions require the reporting of transaction types that until now were not required to be reported to RTRS. Requiring the reporting of these transactions, particularly with special, and likely manual, processing needs such as the addition of the special condition indicator, will take dealers a significant amount of time and resources to implement. The expansion of the use of the special condition indicator, M9cc, in these transactions will allow the MSRB to suppress dissemination of the transparency report on these transactions and thereby prevent publication of a misleading price or otherwise mark the transactions as "off market price." The Association, however, fails to see the benefit of requiring the reporting of these trades and forcing dealers to expend resources to implement these changes, taking into account that there is no benefit to the users of RTRS information looking for information on price transparency due to the fact that the MSRB will suppress dissemination of any transaction with this flag. It is also important to note that the costs of implementing these changes are not solely internal to the dealer, but also result in an increase in transaction assessments dealers will be required to pay the MSRB pursuant to Rule A-13(c) due to additional types of transactions required to be reported to RTRS.

a. *Auction Agent Instruction to Program Dealer*

After an auction is conducted for municipal auction rate securities ("ARS") with multiple program dealers, the auction agent instructs transactions to be made between program dealers pursuant to the auction results. Such transfers of securities are made merely to allow the program dealers collectively to balance their client accounts, taking into account the auction results. A program dealer whose clients have sold securities will need to transfer the securities to another program dealer whose clients have bought securities. It is the view of the Association that more investigation is required by the MSRB regarding auction rate securities processing before requiring the reporting of any transaction between program dealers pursuant to the instruction of an auction agent, particularly transactions with a special condition indicator.

Dealers are handling these transfers currently two ways. Some dealers believe that the transfer between the two program dealers is a mere delivery of securities, not reflective of a purchase-sale transaction. These dealers do not process these transfers through the National Securities Clearing Corporation (NSCC) automated comparison system

(RTTM), but instead clear such transfers through DTCC. The rationale of such treatment is that the reporting of such transfers of securities would overstate the volume of transactions occurring in the relevant security. Other dealers send all transfers and transactions of auction rate securities to RTTM for trade matching. Some dealers mark those transactions for RTTM only (/DEST01) and others mark the transactions for reporting through to RTRS (/DEST01/DEST02). For uniformity sake, we propose that those dealers that do send auction rate securities transactions to RTTM do so for RTTM purposes only (/DEST01). Depending on arrangements with a particular auction agent, auction results are commonly received by the dealer from the auction agent without an indication of whether a particular movement of securities from one program dealer to another is as a result of a bona fide purchase-sale transaction or the mere movement of securities to balance client accounts. This lack of information from the auction agent makes adding a special condition indicator impossible. Additionally, the volume of auction rate securities transfers is so great that even if these transfers were identifiable, flagging certain transactions with special indicators would be operationally impossible (because it would require manual addition of the indicators in a currently automated process). Finally, transactions of auction rate securities as a result of an auction are always at par, thus the only information gleaned from the reporting of these transactions is the volume of the market. The Association believes that changing reporting systems for these securities would require dealers to expend significant resources resulting in no benefit to the users of RTRS information for price transparency information.

b. Repo Transactions

Some dealers have programs allowing customers to finance municipal securities positions through repurchase transactions and some dealers finance their own municipal securities inventory through general collateral repurchase transactions (both generally “repos”). Repos in the first context (customer financing) consist of two parts whereby a dealer will purchase securities from a customer and agree to resell the securities on a future date at a pre-determined price that will include an agreed-upon financing rate. Repos in the second context (dealer financing) consist of two parts whereby a dealer will sell securities to a customer and agree to repurchase the securities on a future date at a pre-determined price that will include an agreed-upon rate of return. Due to the structure of repo transactions and their nature as financing vehicles, typically neither of the two component transfers is executed at a current market price. The MSRB itself has recognized that repo transactions function as a financing agreement and the underlying transactions are not necessarily at market prices.⁴

In the scenario of dealers financing their own municipal securities inventory through general collateral repos, it is important to note that these transactions are sometimes

⁴ See “Rule G-14: Reporting of Transactions Arising From Repurchase Agreements,” MSRB Notice 2004-19 (June 18, 2004).

executed at the asset-class level, and not a specific CUSIP or security level. More specifically, in a general collateral repo trade a dealer will borrow money from a customer and agree to deliver them an equal amount, plus a margin, of municipal bonds or some other bilaterally agreed-upon asset class (such as corporate bonds, US Treasury Bonds, etc.). The repo interest rate for each different asset class is determined according to quality, market supply and market demand. The actual delivery typically settles through a tri-party agent. In this general collateral tri-party flow, the collateral is priced by external vendors contracted by the tri-party agent. Collateral allocation details are then sent back to dealers typically very late in the day. This makes it even more difficult systematically for dealers to report such transfers and makes such information even less meaningful for municipal securities price transparency purposes.

Additionally, repo transactions in most, if not all, broker dealers are entered into and processed through different systems and processes than typical municipal bond trades. For instance, repo component transactions are not processed through RTTM. Requiring reporting of municipal repo component transactions will require substantial operational changes at dealer institutions in order to properly report these transactions to the MSRB. Therefore, because requiring the reporting of repo transactions will be operationally burdensome and have no price transparency benefits for users of the RTRS information, repo transactions should not be required to be reported to RTRS.

It is interesting to note that, for purposes of TRACE reporting to the NASD on corporate bond transactions, bona fide properly documented repo transactions of TRACE-eligible bonds are not viewed as transactions in the secondary market for the purchase and sale of corporate bonds, but, rather, as financing transactions for members.⁵ Thus, such transactions are not reportable to TRACE.

c. UIT-Related Transactions

Dealers sponsoring Unit Investment Trust (“UIT”) or similar programs sometimes purchase securities through several transactions and deposit such securities into an “accumulation” account. After the accumulation account contains the necessary securities for the UIT, the dealer transfers the securities from the accumulation account into the UIT. Purchases of securities for an accumulation account are typically done at a market rate and are reported normally. Transfers of securities out of the accumulation account and into the UIT, however, are not necessarily at market price. In these transactions the dealer is acting merely as a placement agent. The relevant information for RTRS price transparency users is the market price at which the securities were originally purchased. The transfer of securities from the accumulation account into the UIT is not a purchase-sale transaction, but is a mere delivery. Requiring the reporting of

⁵<http://www.nasd.com/RegulatorySystems/TRACE/FrequentlyAskedQuestions/RulesCompliance/index.htm#answer6>

these transactions would also cause an overreporting of the volume of transactions that is occurring for that particular security.

d. TOB Program-Related Transactions

Dealers sponsoring tender option bond programs (“TOB Programs”) for customers sometimes transfer securities previously sold to a customer into a derivative trust from which derivative products are created. If the customer sells the securities held in the derivative trust, the trust is liquidated and the securities are reconstituted from the derivative products and transferred back to the customer. The draft procedures would state that dealers are required to report the transfers of securities into the derivative trust and the transfer of securities back to the customer upon liquidation of the trust using the special condition indicator, even though these transfers are not purchase-sale transactions and are mere deliveries of securities. The Association does not see any value for price transparency users of RTRS in reporting these transfers. Additionally, TOB Programs are typically run by different desks at dealer firms than those which handle typical municipal bond transactions and are thus not in the same processing flow as typical municipal bond transactions. These transfers are not submitted to NSCC for trade matching and settlement. The Association believes that TOB Program-related transactions should not be required to be reported to the MSRB because of their lack of value for price transparency purposes, particularly when the lack of price transparency value is weighed against the burdens of the systems changes that will need to be effected.

2. Inter-dealer Transactions Reported Late

Inter-dealer transaction reporting is accomplished by both the purchasing and selling dealers submitting the trade to the RTTM following NSCC’s procedures. RTTM forwards information about the transaction to RTRS. The two inter-dealer trade processing situations described below are the subject of dealer questions and currently result in dealers being charged with “late” reporting. The Association supports the proposed changes reflected in the draft procedures which would create a new special condition indicator for each scenario, allowing dealers to report these types of transactions without receiving a late-reporting error.

a. VRDO Ineligible on Trade Date

On occasion, inter-dealer secondary market transactions are effected in variable rate demand obligations (VRDOs) in which the interest rate reset date occurs between trade date and the time of settlement. Since the dealers cannot calculate accrued interest or final money on trade date, they cannot process the trade through RTTM until the interest rate reset has occurred. Reporting the trade after the interest rate reset occurs would result in a late trade report.

The draft procedures would require both dealers that are party to the transaction to report the transaction by the end of the day that the interest rate reset occurs, including the trade date and time of trade that the original trade was executed. Both dealers would be required to include a special condition indicator that would cause RTRS not to score either dealer late. Although the Association supports the creation and use of a new special condition indicator to mark VRDO trades ineligible on trade date, the Association believes that the special condition indicator should be also available to be used on customer trades. This indicator should be available for customer trades as well, because even though the MSRB doesn't require final moneys to be calculated on trade date for customer trades, many trading systems do.

b. Resubmission of an RTTM Cancel

A dealer may submit an inter-dealer trade to RTTM and find that the contra-party fails to report its side of the trade. Such "uncompared" trades are not disseminated by RTRS on price transparency products. After two days, RTTM removes the uncompared trade report from its system and the dealer originally submitting the trade must resubmit the transaction in a second attempt to obtain a comparison with its contra-party. The draft procedures would require the dealer that originally submitted information to RTTM to resubmit identical information in the second attempt to compare and report the trade. By the end of the day after RTTM cancels the trade, the resubmitting dealer would include a new special condition indicator that would cause RTRS not to score the dealer late.

The Association applauds the MSRB for this recognition that dealers who have been properly resubmitting trades that failed to compare due to no fault of their own have been scored with late trade reports, and for this resolution to this issue through the creation of a new special condition indicator. We would like to work with the MSRB regarding the implementation of such an option.

3. End-of-Day Deadline for "Away From Market" Trade Reports

The Association is pleased that the MSRB is proposing to provide an end-of-day exception from the fifteen minute transaction reporting deadline for any transaction that includes the M9cc or M2cc special condition indicator. Currently, the two special condition indicators used to identify "away from market" trade reports, M9cc and M2cc, do not provide dealers with an extension to the fifteen minute transaction reporting deadline. The purpose of fifteen minute reporting is to provide real-time price transparency. Transactions that are not included on price transparency products are not relevant to the price transparency purpose of RTRS so there is not a need to have such transactions reported to RTRS in real-time. In addition, many special condition indicator

situations described in this notice require manual processing on behalf of dealers or use of different trade processing systems.

4. *Response to MSRB's Specific Questions*

a. *Timing of Implementation*

The Association has stated in previous comment letters that it prefers to institute multiple RTRS system changes on a single implementation date because it is less costly and more efficient if such changes are effected collectively. We have previously stated that July 31, 2007 would be an appropriate date for the implementation of various RTRS changes because that was the anticipated date of the rollout of the DTCC New Issue Information Dissemination System (NIIDS) project. The Association believes that a period of at least nine months following the publication of final Specifications, as long as that date is not earlier than July 31, 2007, is needed to implement the proposals in this Notice regarding special condition indicators due to the technical and operational challenges to implementation of the proposal. The Association also believes it is important to note that many dealer firms have freezes on systems changes at various points throughout the year, and that common times for such freezes are year end (December into January) and June (for the annual rebalancing of certain market indices). These time frames would best be avoided as required implementation dates.

b. *Number of Indicators*

The Association appreciates the MSRB's recognition of the complexity that is added to trade reporting with more special condition indicators. The Association supports using the existing generic M9cc special condition indicator on transactions executed at special prices so that the creation of additional indicators is not necessary. Although we recognize that the generic indicator does not provide the MSRB with the flexibility of including such trade reports in price transparency products with a specific explanation of why the price may not be at market price, we believe that such information is not indicative of market conditions or otherwise helpful to users of the MSRB's price transparency products.

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Mr. Justin Pica
Municipal Securities Rulemaking Board
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Page 8 of 8

We look forward to discussing these issues further with the MSRB Board and staff and appreciate your consideration of our comments on this proposal. Please contact the undersigned at 646.637.9230 or via email at Lnorwood@bondmarkets.com with any questions that you might have.

Sincerely,

/s/ Leslie M. Norwood

Leslie M. Norwood
Vice President and
Assistant General Counsel

cc: ***Municipal Securities Rulemaking Board***

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The Bond Market Association

Municipal Executive Committee
Municipal Policy Committee
Municipal Legal Advisory Committee
Municipal Operations Committee
Municipal Syndicate & Trading Committee
Municipal Brokers' Brokers Committee
Municipal IDB Working Group