

## Comment Letter on MSRB'S Municipal Market Professional Guidance, March 2002

March 4, 2002

Mr. Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, DC 20549-0609

**Re: Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Transactions with Sophisticated Municipal Market Professionals  
(File No. SR-MSRB-2002-02)**

Dear Mr. Katz:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the proposed interpretive notice by the Municipal Securities Rulemaking Board ("MSRB") regarding the application of MSRB rules to transactions by brokers, dealers and municipal securities dealers (collectively, "dealers") with sophisticated municipal market professionals ("SMMPs").<sup>2</sup> The MSRB's stated primary purpose in providing interpretive guidance in this area is to interpret MSRB rules to allow the development of trading relationships where the dealer acts as an order taker in secondary market non-recommended municipal securities transactions with sophisticated institutional customers. The Institute supports this objective. However, as we stated in our previous comment letters on the MSRB's earlier versions of its draft guidance,<sup>3</sup> our support is conditioned on the guidance being revised (1) to limit the applicability of the SMMP concept to electronic trading platforms, and (2) to exclude from the SMMP safe harbor certain securities that are exempt from the continuing disclosure requirements of Rule 15c2-12 under the Securities Exchange Act of 1934.

We are disappointed that the MSRB did not accept our recommendations and revise its interpretive notice accordingly. We would like to reiterate our concerns about reducing certain of the MSRB's fair practice standards regarding a dealer's disclosure obligations in view of the current disclosure inadequacies in the secondary municipal securities market, and also reiterate the importance of applying the SMMP concept narrowly to ensure that all investors have timely access to material information to enable an informed investment decision. Accordingly, we urge that the MSRB's interpretive notice be revised in the manner that we previously recommended.

Our comments below are intended to clarify those recommendations.

### 1. Electronic Trading Platforms

We continue to believe that the SMMP concept should be limited to electronic trading platforms. We believe that there are discernible benefits of trading through electronic platforms and recognize that the application of certain of the MSRB's rules as currently interpreted might hinder the development of such platforms for municipal securities. For this reason, we believe that the MSRB's proposal to reduce certain dealer obligations in order to permit the development of these platforms is appropriate. The same reduction in dealers' obligations, however, is neither necessary nor appropriate when trading through other mediums, such as by telephone or in person. Taking the dealer out of the disclosure loop in a disclosure distribution system that is woefully inadequate should only be done where the benefits of doing so clearly outweigh the detriments.

The MSRB's proposal to extend the SMMP concept to non-electronic transactions is based upon the faulty premise that information that is publicly available can be accessed on a timely basis by all SMMPs. The SEC's recent survey establishing the unreliability of the nationally recognized municipal securities information repository ("NRMSIR") system provides clear evidence that even sophisticated persons are not always able to obtain putatively publicly available information.<sup>4</sup> The survey found that the availability of

annual reports required under SEC Rule 15c2-12 for a random sample of municipal bonds subject to the rule's continuing disclosure obligations requirements ranged from a maximum of 75 percent at one NRMSIR to 57 percent at another NRMSIR.<sup>5</sup>

In the event that the MSRB does not limit its interpretive notice in the manner we recommend, it is imperative that the impact of its interpretive notice, and the associated diminution in a dealer's affirmative disclosure obligations, on the distribution of secondary market disclosure be closely monitored. In this regard, we strongly urge that the MSRB undertake to study this impact within one year after its final adoption.

## 2. Exchange Act Rule 15c2-12

The SMMP concept should not apply to private placement securities and securities exempt from the disclosure requirements of Rule 15c2-12 under the Exchange Act, such as variable rate demand obligations (collectively, "Exempt Securities"). As we noted in our previous letter, the premise underlying the SMMP concept, i.e., that information about a security is already disclosed to the public, is not applicable to these securities. The MSRB's response suggested that if an SMMP is dissatisfied with a transaction due to a dealer's non-disclosure of information, then the SMMP "can recognize that risk and take appropriate action, be it declining to transact, undertaking additional investigation, or asking the dealer to acquire additional information."<sup>6</sup> The Institute notes that these options are not always effective with respect to Exempt Securities; moreover, they fail to recognize the unique aspects of these securities.

While it is true that customers can always decline to purchase securities, that is not an attractive option in a market where demand far exceeds supply. Indeed, it would be highly unfortunate for the Commission to acquiesce in a regime where investors are asked to sacrifice their ability to receive key information if they wish to participate in a securities market. We respectfully submit that this is fundamentally at odds with the basic premise of U.S. securities regulation.

In addition, undertaking additional investigation or asking the dealer to acquire additional information is not infrequently an exercise in futility. For Exempt Securities, there is no known repository of publicly available information. Moreover, there is no assurance that any request of the dealer to acquire the requisite information would be honored in a timely manner, if at all.

The MSRB's stated response to our recommendation to exclude Exempt Securities was that "investors' comments may incorrectly assume that remarketing agents usually are effecting secondary market transactions in exempt securities (i.e., VRDOs)."<sup>7</sup> While the MSRB correctly points out that remarketings on behalf of an issuer constitute primary offerings under Exchange Act Rule 15c2-12 as to which a dealer's obligations under MSRB Rule G-17 and G-18 would remain unaffected, that is not necessarily the case for all remarketings. We understand that in many instances it is not uncommon for dealers to effect transactions in VRDOs as secondary market transactions in order to avoid a formal put of the VRDO and associated requirements under the bond documentation. Often, if a holder of the VRDO wants to sell the security, the dealer will purchase it and resell it, bypassing the put/remarketing mechanism. Thus, contrary to the MSRB's statement, many transactions in VRDOs will in fact be subject to the reduced SMMP standards if transactions in Exempt Securities are not expressly excluded from the scope of the SMMP concept.

## 3. Dealers' Duty Not To Mislead Customers

We are pleased that the SEC Release makes clear that a dealers' duty not to engage in deceptive, dishonest, or unfair practices under Rule G-17 or under the federal securities laws would not in any way be altered under the MSRB's interpretive guidance. We were particularly pleased with the statements in the release that, "a dealer's intentional withholding of a material fact about a security, where the information is not accessible through established industry sources, may constitute an unfair practice violative of Rule G-17. In addition, a dealer may not knowingly misdescribe securities to the customer."<sup>8</sup> We interpret the latter statement to mean, for example, that if a dealer states that a security is eligible for a money market fund, but in fact it is not, then the dealer would be in violation of Rule G-17.

The continued application of Rule G-17's fair dealing obligations on dealers is critical, especially in view of a dealer's reduced suitability obligations when dealing with SMMPs. As we stated in our previous letter, given the importance of this point, we recommend that it be reiterated in the MSRB's final interpretive notice.

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The Institute appreciates the opportunity to comment on the MSRB's interpretive notice. If you have any questions or would like additional information, please contact me at (202) 326-5824 or Barry Simmons at (202) 326-5923.

Sincerely,

Amy B.R. Lancellotta

Senior Counsel

**Attachment**

cc: Martha M. Haines  
Director  
Office of Municipal Securities  
Securities and Exchange Commission

Diane G. Klinke  
General Counsel

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Municipal Securities Rulemaking Board

**ENDNOTES**

<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. Its membership includes 9,040 open-end investment companies ("mutual funds"), 487 closed-end investment companies and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.952 trillion, accounting for approximately 95 percent of total industry assets, and over 88.6 million individual shareholders.

<sup>2</sup> Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Transactions with Sophisticated Municipal Market Professionals, SEC Release No. 34-45364 (January 30, 2002); 67 Fed. Reg. 6294 (February 11, 2002) ("SEC Release").

<sup>3</sup> See Letter from Amy B. R. Lancellotta, Senior Counsel, ICI, to Carolyn Walsh, Associate General Counsel, MSRB, dated October 19, 2001; Letter from Amy B. R. Lancellotta, Senior Counsel, ICI, to Ernesto A. Lanza, Associate General Counsel, MSRB, dated [November 30, 2000](#). For your convenience, we have attached a copy of our [October 2001 letter](#).

<sup>4</sup> See Lynn Hume, Dysfunctional Disclosure—Sources: SEC Survey Finds System Not Working, *The Bond Buyer*, February 22, 2002.

<sup>5</sup> The article adds that "the survey results provide evidence that neither dealers nor investors can rely on the current secondary market disclosure system to make sure they are getting key information about municipal bond issues on an ongoing basis." *Id.*

<sup>6</sup> SEC Release at 6306.

<sup>7</sup> *Id.* at n. 78.

<sup>8</sup> SEC Release at 6296.