

# National Federation of Municipal Analysts

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*Re: Notice and Draft Interpretive Guidance on Dealer Responsibilities in  
Connection with Both Electronic and Traditional Municipal Securities  
Transactions*

Dear Ms. Walsh and Mr. Lanza:

We welcome this opportunity to comment on the Municipal Securities Rulemaking Board's Notice and Draft Interpretive Guidance (the "Draft Interpretive Guidance") in connection with both electronic and traditional municipal securities transactions. As you may know, the National Federation of Municipal Analysts ("NFMA") is an organization composed primarily of research analysts who evaluate credit and other associated risks of securities in the municipal market. Established in 1983, the NFMA has roughly 1000 members who represent, among others, broker/dealers, mutual funds, rating agencies and insurance companies.

The NFMA understands the need of the dealer community for guidance regarding the applicability of the MSRB rules in the context of electronic trading systems. As the Draft Interpretive Guidance notes, electronic trading systems are relatively novel in the municipal securities market, are operated in a variety of ways, and involve brokers and dealers in capacities which, in some instances, differ from the functions performed by broker-dealers in traditional transactions. These differences raise interesting questions under the MSRB rules, and deserve to be addressed. The NFMA applauds the MSRB's objective of facilitating access to electronic trading systems by investors, which underlies the MSRB's attempt to clarify the duties of brokers to customers trading on such systems. The NFMA believes that properly operated electronic trading systems may provide an advantageous mechanism for the trading of municipal securities, and endorses equitable access by all investors to such systems.

Although the MSRB's objective is laudable, the NFMA has substantial concerns with the approach taken by the MSRB. In the course of addressing the application of the MSRB rules to electronic trading systems, the Draft Interpretive Guidance veers off course in a manner that substantially reduces the duties under the MSRB Rules of brokers and dealers to a category of investors, "sophisticated market professionals", created by the Draft Interpretive Guidance. In



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particular, the Draft Interpretive Guidance absolves brokers and dealers dealing with “sophisticated market professionals” from their existing fair dealing obligation, under Rule G-17, to disclose all material facts to customers, as well from the obligation to make reasonable efforts to execute transactions at prices that are fair and reasonable under Rule G-18 and to make suitability determinations under Rule G-19. No compelling rationale or need is stated for the exclusion of this newly-coined investor class from the protections previously afforded under the MSRB Rules to all investors in municipal securities. Moreover, almost as an aside, the Draft Interpretive Guidance states that “although the MSRB has issued the draft interpretive guidance ... as a result of the recent emergence of electronic trading systems in the municipal securities market, the MSRB wishes to make clear that such draft guidance would apply irrespective of whether the transaction is done electronically, over the telephone or in person.”

The NFMA has strong reservations about the “sophisticated market professional” concept, and urges the MSRB to revise the Draft Interpretive Guidance in a manner that focuses on how to make the MSRB rules work in the context of electronic trading systems, rather than on wholesale reformulations of the relationship between dealers and certain of their customers. The NFMA believes the Draft Interpretive Guidance as written would have unjustified detrimental consequences for investors who are deemed to constitute “sophisticated market professionals”, as well as for other investors in municipal securities.

First, there is a fundamental misconception inherent in the “sophisticated market professional” concept. The misconception is the existence of an identifiable category of investors with sufficient direct access to material facts about all municipal securities to obviate the need for brokers and dealers to provide material information about municipal securities to such customers. The Draft Interpretive Guidance overestimates the information available to investors of any ilk in the municipal securities market, and underestimates the role of the dealer as a centralized purveyor of available information about particular securities.

The Draft Interpretive Guidance suggests that “sophisticated market professionals” include those that have research analysts and access to nationally recognized municipal securities information repositories (NRMSIRs), state information depositories (SIDs), the MSRB’s MSIL library and rating agency reports. But such repositories provide at best a patchwork of the primary disclosure required to be filed under MSRB Rule G-36 and the minimal, and often stale, continuing disclosure required to be filed under SEC Rule 15c2-12. A substantial number of municipal securities, ranging from money market securities to small issues to limited offerings, are exempt from the filing requirements under SEC Rule 15c2-12. With respect to securities subject to the rule, the only disclosure required to be filed is annual disclosure that may be outdated by up to seven fiscal quarters. Rating agency reports are sporadic and cannot be relied upon to fill the substantial gaps in meaningful, current disclosure about municipal securities. Accordingly, in contrast to the equity and corporate debt markets, in which centralized online quarterly disclosure is the norm for issuers of publicly traded debt, municipal investors, however sophisticated, do not have the ready access to all material information that the “sophisticated market professional” concept assumes.

Due to the deficits in the disclosure made publicly available to all investors under current regulatory requirements, such information frequently is supplemented by public and quasi-public information that is not filed with repositories. For example, issuers may be required by covenants in trust indentures or loan agreements to provide quarterly financial and operating information, and other specified information, to bondholders and/or underwriters. A dealer that has a position



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in municipal securities may have such information, which is not required to be filed with the NRMSIRs and may not be directly accessible to a potential buyer of the securities. Because dealers may possess material information that is not necessarily available to research analysts for institutional investors, there is no reliable basis for a determination by a dealer that a particular customer is on equal informational footing with the dealer, and therefore no coherent way of establishing the existence of a “sophisticated market professional” within the meaning of the Draft Interpretive Guidance.

In addition to depriving those investors that are deemed “sophisticated market professionals” of the benefit of material information possessed by dealers, there is a likelihood that the two-tier regulatory system promoted by the Draft Interpretive Guidance will have adverse consequences for investors that are not deemed “sophisticated market professionals.” If the obligations of dealers operating electronic trading systems are substantially reduced for one category of investors, but remain in place for other investors, there will be an incentive for many if not most electronic trading systems to exclude retail and other “non-sophisticated” investors from such systems, thereby depriving them of the execution efficiencies such systems may offer. The same phenomenon may weaken the relative depth of opportunities available to retail and other “non-sophisticated” investors in the traditional markets. On the flip side, dealers that cater to both tiers of customers, whether in electronic or traditional trading transactions, still will need to invest the resources to provide all material information to one category of investors; there is no apparent benefit to such dealers in excusing them from providing such information to “sophisticated market professionals.”

For these reasons, NFMA believes that the MSRB should set aside the concept of the “sophisticated market professional” and refocus the Draft Interpretive Guidance on the practical aspects of implementing the MSRB rules in the context of electronic trading systems in a manner that is workable for dealers and attentive to the needs of all customers in a market in which complete and current information about municipal securities remains an aspiration, not a reality.

Very truly yours,

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Dina W. Kennedy  
Chairman of NFMA

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Mary Metastasio  
Chairman of NFMA's Industry and  
Practices Procedures Committee

