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THE BOND MARKET ASSOCIATION

September 12, 2003

Harold L. Johnson
Deputy General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street
Suite 600
Alexandria, VA 22314

Re: Comments Related to Implementation Plan for Trade Dissemination as outlined in MSRB Notice 2003-23

Dear Mr. Johnson:

The Bond Market Association ("Association")[1] is pleased to comment on those aspects of Notice 2003-23 ("Notice") issued by the Municipal Securities Rulemaking Board ("MSRB" or "Board") that concern the proposed real time dissemination of price information of municipal bond transactions.

The Notice sets out the MSRB's proposal for implementing a system to capture municipal securities trade information on a real-time basis by the middle of 2004, and also to immediately disseminate all transaction prices that are reported. For the reasons described below, the Association believes that questions regarding implementation of the real-time trade reporting system (which we agree is necessary to ensure a robust regulatory surveillance environment), and questions regarding immediate price dissemination for all reported trades, each involve a distinct set of practical and policy questions and should be dealt with independent of one another. The Association is therefore responding to each of these issues separately. This letter concerns price dissemination. The Association has submitted a separate comment letter concerning the MSRB's proposal regarding real-time trade reporting.

As further detailed below, consistent with its prior statements on this topic, the Association supports immediate price dissemination for municipal bond transactions, except for a narrow set of bonds and transactions where liquidity would likely be adversely impacted by such immediate dissemination. As to that class of bonds and transactions, we believe that the MSRB should conduct further study to ensure that the

[1]The Association represents securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally. The Association's Member firms collectively represent in excess of 95% of the initial distribution and secondary market trading of municipal bonds, corporate bonds, mortgage and other asset-backed securities and other fixed income securities. More information about the Association is available on its website, www.bondmarkets.com.

benefits to market participants outweigh the costs to liquidity that would likely be a consequence of immediate dissemination.

Proceeding at a more deliberative pace with respect to relatively illiquid securities ensures that investors are not unduly harmed by the consequences of regulatory actions intended for their benefit. Such action is consistent with the approach taken by other self-regulatory agencies in other sections of the fixed-income markets. For example, in the case of the NASD's TRACE system, the concern about the potential liquidity impact of real-time transparency on the market for high yield bonds was reflected in the rules adopted by the SEC. In that regard, price dissemination has been limited at the outset to higher credit bonds of large issue size. The NASD is now engaged in a deliberate, controlled study of the effect of dissemination on the market for 120 "BBB" bonds, before making further decisions as to whether and how to include high yield bonds in its transparency regime. We strongly recommend that a similar methodical approach be implemented for municipal bonds. Proceeding at a more deliberative pace would also be consistent with Securities and Exchange Commission ("Commission") pronouncements which recognize the importance of liquidity to investors.[2]

Background

Beginning in 1995, the MSRB gradually has expanded the universe of municipal bond transactions that are reported to it, as well as the dissemination of such information to the marketplace. At present, trade details for each municipal CUSIP that trades in a single day are publicly disseminated on a next day basis. The Association consistently has been supportive of the steps that the MSRB has taken to date to extend transparency in the municipal market.[3] Our support for enhanced transparency in the municipal market is based upon the unique retail investor participation in that market. We recognize that public dissemination of prices would have a benefit to the price discovery process and help ensure that individuals are executing municipal bond transactions at prices reasonably related to the prevailing market price for such bonds. In the context of the municipal market to date, the benefits to the marketplace of enhanced transparency in the manner currently employed have outweighed the costs to liquidity. In addition, since 1998, the Association has supported the goal of greater transparency by formatting and

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[2] In 1991, the NASD created the FIPS system to improve transparency in the high yield corporate bond market. In the letter that accompanied his report to Congress, then SEC Chairman Richard Breeden acknowledged the difficulty and possible harm that mandating increased price transparency for the entire high yield market could cause: It may be possible and desirable to substantially improve transparency...for much of the high yield bond market. However, mandating increased transparency for the large segment of the market that is illiquid could further reduce dealer participation in that segment of the market, and is therefore only practical where a "critical mass" of market participants exists. Senate Comm. on Banking, Housing and Urban Affairs, Report by the Division of Market Regulation on Transparency for High-Yield Debt Securities (Sept. 6, 1991).

[3] *See, e.g.,* Letter from Frank Chin, Chair, Association's Municipal Executive Committee, to Mr. Jonathan G. Katz, Secretary, SEC, dated August 8, 2002, commenting on File No. SR-MSRB-2002-07, and Letter from John Ramsay, Association Senior Vice President and Regulatory Counsel, to Mr. Jonathan G. Katz, Secretary, SEC, dated May 9, 2003, commenting on File No. SR-MSRB-2003-02.

retransmitting the price information that is disseminated by the MSRB in a form that can be readily utilized by retail investors.[4] At the same time, the Association has consistently raised the concern that immediate price dissemination of price information for some bond trades could hurt the liquidity of the market for those bonds[5].

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We strongly believe that the MSRB should not move forward with a price dissemination plan until questions regarding the liquidity impact are resolved. Set forth below are some suggestions we believe the MSRB can implement to achieve the goals set forth in the Notice.

Separating Trade Reporting from Dissemination

As noted, the Association believes that it is important to consider the issues of trade reporting and dissemination as separate and distinct questions, in terms of both practical and public policy implications. We support real-time trade reporting, provided that it is accomplished in a manner and on a timetable that does not impose undue systems and compliance costs on reporting firms. These issues are fully described in our comment letter on this aspect of the Notice.

In contrast to the regulatory objective of trade reporting, which is undeniably critical to provide information that regulators need to ensure firms are complying with their regulatory obligations, dissemination of information on a real-time basis involves questions of impact on liquidity. Achieving the goal of trade reporting on a real-time basis does not by any means resolve the question of whether some subset of the information that is reported should be disseminated to the marketplace at large on the same basis. Having the technology in place and requiring reporting to regulators should not dictate the answer to questions regarding dissemination of the data.

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[4] Through its web site, www.investinginbonds.com, the Association allows users, for each day's trades, to sort the information provided by the MSRB according to the state in which the municipal issuer is located, as well as according to various other criteria, including, among others, credit rating, maturity, coupon, and CUSIP. Users also can use this engine to search for historical trade information for specific CUSIPs, using an historical of price information dating back to June of 2000.

[5] For example, most recently, in its comment letter to the SEC dated May 9, 2003, the Association suggested that the MSRB should resolve the following questions before adopting further transparency measures:

- Does the MSRB believe that transparency of bonds prices on a real-time basis could have a negative impact on the market for some municipal bonds? What is the basis for its conclusion in this regard?

- In particular, has the MSRB undertaken any academic studies or conducted research on this issue? If so, what is the nature of those efforts? If not, would the MSRB be willing to undertake such an effort, either separately on in conjunction with the Association or others?

Evaluating the Impact on Liquidity of Real-Time Dissemination

In General

The concern that real-time dissemination could harm the liquidity of the market for some bonds is fairly straightforward. In some cases holdings of individual municipal bond issues are concentrated in the hands of a few dealers or buy-side institutions. This is especially likely to be true when a bond has been outstanding for a considerable period of time or has a low or uncertain credit standing. These bonds typically are difficult to value, and trades that do occur often happen at disparate prices reflective of significantly different opinions regarding the municipal credit or other variables in the price discovery process, including a dealer's willingness to inventory such bonds and their appetite to commit capital to the market making function for such security.

An investor wishing to dispose of bonds of this type usually will sell them to a dealer, which will hold the bonds in inventory for some period of time, unless at the time of the trade the dealer is able to find other market participants who are interested in purchasing bonds with similar characteristics. In purchasing the bonds, the dealer takes on greater market risk, in comparison to other bonds it holds in its inventory, and the extent of the risk is obviously proportionate to the size of the trade and the execution price. Unless there are other ways to hedge the risk (which generally is quite difficult, if not impossible, with bonds of this type), the ability to manage the position depends on its ability to resell the bonds in one or a series of transactions with other dealers and/or investors. The dealer's bid for the bonds in the first instance will be reflective of its assessment regarding these risks. Clearly, a less aggressive bid, resulting in a lower price to the investor, will ensue due to the greater the risks to the dealer.

Disseminating price information immediately following a large transaction in bonds of this type signals to active and knowledgeable market participants that a dealer has acquired bonds that it will be looking to resell within a reasonable period of time. This information, in turn, is likely to have a negative effect on the price(s) the dealer is able to obtain in reselling the bonds. Accordingly, immediate price dissemination for bonds that are infrequently traded and difficult to trade will likely mean that dealers will either be less willing to supply liquidity to the market by buying bonds in these circumstances, or else will only buy them at a discounted price that accounts for this additional risk. The interest of investors in having sources of liquidity that they can access in managing their own portfolios can thereby be compromised.

TBMA Proposal

The Association offers the following proposal as a way of both promoting transparency in the municipal market for those securities and trades that we believe do not raise concerns about liquidity impacts, while trying to fully understand and measure the extent of those impacts in that part of the market that is vulnerable to them. Our proposal consists of the following elements.

Show All Trades for High Credit Bonds

When real-time trade reporting is put in place[6], the Association recommends that the MSRB should at the outset immediately disseminate reported price information for all bonds that are rated "A" or higher by a nationally recognized statistical rating organization ("NRSRO"). We believe that these criteria would at present capture approximately 99% of the market by dollar volume.

Show Greater Size for Trades in High Credit Bonds

Consistent with its current practice, the MSRB has proposed, with respect to large block trades, to limit the actual trade size that is shown for trades less than $1 million, and to designate "$1 million plus" for trades that exceed $1 million. A number of our Members think it would be appropriate to increase the amount of the trade size that is disclosed for higher quality bonds. We would propose that the MSRB consider disseminating actual trade size up to $5 million for trades in bonds that are rated at least "A" by an NRSRO. For trades that exceed $5 million, a "$5 million plus" designation could be used. Actual trade size for trades exceeding $5 million would continue to be made publicly available five days after the trade.

Disseminate All Price Information for Smaller Size Trades

The MSRB should disseminate price information for all trades that are at a relatively small size, regardless of the rating. For this purpose, we would suggest a cutoff point of $1 million or less. Disseminating this information would help to supply information on the great majority of trades that are done with individual investors, which is likely to be of particular interest to other individual investors, without posing the liquidity concerns identified above. Trades less than $1 million represent approximately 92% of the total number of trades that are now reported to the MSRB.

Focused Review of Liquidity Impact for Other Bonds

The MSRB should take advantage of and draw on the Association's efforts, and the efforts of other market regulators, to study the liquidity impact of immediate price dissemination for infrequently traded bonds[7].

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[6] The Association recommends that the Board consider implementing the public dissemination of trade data on a real time basis at the point when industry compliance with real time trade reporting reaches a significant level. This would ensure that the real time dissemination of trade details would encompass the vast majority of trades, and not be misleading to an investor.

[7] The MSRB might consider a limited dissemination on a pilot basis of trades other than those that would already be disseminated under the regime described above (essentially, trades above $1 million in size in bonds that are rated below "A").

In considering this question as it relates to the municipal market, the Association formed a Municipal Price Transparency Task Force, consisting of both sell-side and buy-side participants. This Task Force engaged National Economic Research Associates ("NERA"), a nationally known economic research firm, to conduct a study to determine if previous MSRB moves to increase transparency (reporting CUSIPs that trade three times per day to those that trade twice per day to those that trade once per day) have had any discernable effect on liquidity. NERA used regression analysis to determine liquidity effects. At this point, we can report preliminary findings, although it should be noted that refinements of the methodology may be required before any results can be considered final.

While the results should still be considered preliminary in nature, NERA's initial analyses of the municipal bond transactions data differentiated based on rating and issue size clearly suggest that the changes in trade disclosure rules of May 2002 and December 2002 had liquidity reducing effects in the municipal bond market. Moreover, these preliminary results indicate that the December 2002 rule change may have had a greater effect than the May 2002 rule change. That is, there are clearer indications of lower bond liquidity after the December 2002 rule change than after the May 2002 rule change. As you know, in May 2002 the MSRB reduced the threshold for number of transactions triggering next day reporting from 4 trades to 3 trades. In December 2002, the threshold was reduced from 3 trades to 2.

The study measured market liquidity before and after each rule change using regression analysis and a methodology known as an "event study." Bonds were grouped by rating, and average liquidity measures for each rating group were compared before and after each event. Three measures of bond liquidity were used: average weekly volume, average weekly number of trades, and average weekly trade size defined as the ratio of the other two variables. The study was conducted with various specifications for the liquidity measures and issue size, and various groupings of bonds by rating.

The results vary by the liquidity measure used, and specifications of variables, for instance, how the bond rating groups are defined. However, there is enough consistency across the variations in the regression models for us to conclude that the results are reliable.

In a number of the regressions, the bond liquidity measure dropped after the event. In some cases, the results are consistent with an interpretation that the drop in liquidity was greater for bonds of lower issue size. The Association would be pleased to share these preliminary results with the Board, and to assist in developing additional studies that the Board may wish to undertake.

Short Term Debt Instruments

In our companion comment letter which addresses real time trade reporting we suggest that variable rate demand obligations, commercial paper trades, auction rate instruments and other short term debt instruments be exempt from 15 minute reporting. Rather we recommend that these trades be reported by end-of-day, which would still support MSRB's ability to track the flow of funds among these short-term municipal instruments. In light of the fact that these instruments trade at par, and that the price of "par" has minimal value to investors, we believe that immediate reporting of these trades has limited usefulness, and recommend that the reporting, and therefore the public dissemination of trades for variable rate demand obligations, commercial paper, auction rate instruments and other short term instruments occur end-of-day.

New Issues

The Association's companion comment letter also recommends that trades on the first day of a new issue released to market be exempt from 15 minute reporting, and, with limited exception, be submitted no later than end-of-day. Likewise, public dissemination of new issue trades should occur after those trades have been reported. The MSRB should be aware however, that new issue trades generally reflect market conditions that prevailed during the issue's order period, which precedes – often by several days – the receipt of the official contractual award, which allows the underwriters to proceed with writing tickets. On the initial trade date for a new issue, there will likely be secondary market trades reflecting that day's market environment, in addition to booking the primary tickets at the prices agreed to by the original buyers days before. This mix of new issue and secondary market trades may well mislead some investors as to prevailing market prices on initial trade date.

ATS Designation

The Association requests additional information from the Board on the utility of reporting and public dissemination of an ATS designation. We note that trading information through ATSs is already reported to the Commission and we would support the Board's request to the Commission to share with them the information being supplied by the registered ATS.

Conclusion

In summary, we appreciate the opportunity to provide our views to the MSRB on the critical issues relating to the implementation of a price dissemination plan in the municipal market. Our goal is to promote immediate dissemination of the vast majority of municipal bond transactions, but request further study on the narrow set of transactions where liquidity would likely be adversely impacted by such immediate dissemination. We trust that our comments will be carefully considered. Even in this time of increasing regulatory compliance pressure for Member firms, we do however, continue to seek ways to support additional price transparency while responding to investor demands for liquid markets.

We look forward to discussing these issues further with the MSRB staff, and appreciate your attention to our comments. Please contact the undersigned at 646.637.9218 or via email at Lhotchkiss@bondmarkets.com with any questions that you might have.

THE BOND MARKET ASSOCIATION

Sincerely,

Lynnette Kelly Hotchkiss

Lynnette Kelly Hotchkiss
Senior Vice President and
Associate General Counsel

cc: *Securities and Exchange Commission*

The Honorable William H. Donaldson, Chairman
The Honorable Cynthia A. Glassman, Commissioner
The Honorable Harvey J. Goldschmid, Commissioner
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner

Giovanni P. Prezioso, General Counsel, Office of the General Counsel
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The Bond Market Association

Executive Committee, Municipal Securities Division
Legal Advisory Committee, Municipal Securities Division
Policy Committee, Municipal Securities Division
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Operations Committee, Municipal Securities Division
Syndicate and Trading Committee, Municipal Securities Division
Price Transparency Task Force, Municipal Securities Division