Government Finance Officers Association
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November 10, 2011

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington D.C. 20549-1090

RE: Municipal Securities Market

Dear Ms. Murphy:

Thank you for the opportunity to continue to comment on various issues in the municipal securities sector. While we have commented previously on issues related to disclosure standards, the Government Finance Officers Association (GFOA) would like to also comment on the need for greater bond pricing transparency. The GFOA is the professional association of state, provincial and local finance officers in the United States and Canada, and has served the public finance profession since 1906. We provide leadership to our 17,000 members through various research and education efforts, as well as the identification and promotion of best practices.

While there may be other price transparency issues that need to be addressed, a longstanding area of concern to our members is the practice of broker-dealers reporting the initial sale of bonds as “not re-offered” (NRO). As you will see from the attached letters previously sent to the Municipal Securities Rulemaking Board (MSRB) from GFOA and Frank Hoadley of the State of Wisconsin, this is a practice that masks important pricing of primary market bonds. A NRO designation camouflages what is actually happening with those bonds. It is very unlikely that the broker-dealer itself is investing in the bonds it is selling. The attached letters sent previously by the GFOA and Frank Hoadley from the State of Wisconsin, to the Municipal Securities Rulemaking Board, shed additional light on this subject.

We would be happy to further discuss this matter with you and your staff.

Sincerely,

Susan Gaffney

Susan Gaffney
Director, Federal Liaison Center

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November 1, 2010

Ms. Lynnette Kelly Hotchkiss
Executive Director
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Dear Lynnette:

Thank you again for the opportunity to provide the MSRB with input about the work that they can do in order to help "protect issuers.'

As a follow-up to our October 27th letter, attached please find a letter that Frank Hoadley (Capital Finance Director, State of Wisconsin), sent to the MSRB in 1998 regarding the NRO designation on new bonds. While dated 12 years ago, the letter still holds true today, and provides an excellent overview of the issue, and possible solutions.

We trust that the MSRB will give this careful review, and we look forward to discussing this and other issues with you in the near future.

Sincerely,

Susan Gaffney

Susan Gaffney
Director, Federal Liaison Center

cc: Frank Hoadley, Chairman Governmental Debt Management Committee

STATE OF WISCONSIN
DEPARTMENT OF ADMINISTRATION
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TOMMY G. THOMPSON
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March 12, 1998

Christopher A. Taylor, Executive Director
Municipal Securities Rulemaking Board
1150 18th Street, NW, Suite 400
Washington, DC 20036-2491

Dear Mr. Taylor:

This letter is in response to your request for additional information about our concern over "NRO" price reporting. We have previously discussed our concerns about this growing practice with Mr. Dean Pope and Ms. Phyliss Currie who, we believe, raised the issue for discussion at the last MSRB quarterly meeting. I have also raised this issue as an issue to monitor with the Debt and Fiscal Policy standing committee of the Government Finance Officers Association, however the committee has not as yet taken action.

This is written in my capacity as Capital Finance Director of the State of Wisconsin Department of Administration. This office is responsible for all bond issuance by the State and for administration of the State's outstanding bonds. The State sells, on average, six to ten issues each year of both short and long term securities in several different credit structures totaling about $1.0 billion per year. Over time about 75% of the State's sales are competitive and about 25% are negotiated. The opinions expressed in this letter are the professional opinions of the Capital Finance Office, but do not represent formally adopted policy positions of the State of Wisconsin, the State of Wisconsin Building Commission or the Governor.

<u>Introduction.</u> The recent focus of attention on the municipal bond industry is bringing changes that add to the efficiency and integrity of the industry. One of those changes has been the push toward market transparency. We are concerned about a market practice that seemingly is being overlooked in efforts to improve price transparency for market participants. The practice is that of broker-dealer reporting of sales as "NRO", standing for "not re-offered," in connection with primary market bond sales. The reality, of course, is that virtually all bonds are re-offered by broker-dealers. Broker-dealers do not normally act as investors in municipal bonds. Somewhat more disturbing is what appears to be a trend toward increased use of "NRO" price reporting.

We appreciate the work the MSRB has put into development and implementation of the much-delayed revisions to the Customer Transaction Reporting Program and into G-32. We need to point out, however, that these efforts do not benefit nor address the more fundamental concerns of bond issuers, investors and other market participants who need to understand pricing of the municipal market as it is occurring. It is important to have a marketplace that is price transparent to issuers and investors.

This issue is not to be confused with printing "NRO" in the final official statement for competitive bond sales (a practice not permitted by most experienced bond issuers), or about the fact that bond prices are reported to issuers by way of the underwriter's certificate given for purposes of allowing the issuer to calculate the arbitrage yield limit for a bond issue to report on form 8038. This issue is about real time market reporting which occurs within minutes of a competitive bond sale bid opening (or during a negotiated sale marketing period). The issue is about the information that is reported to the marketplace on TM3, Reuters, Dow Jones Telerate and Bloomberg information services and which is printed in *The Bond Buyer* the following day. This information is very important to both issuers and investors who are trying to make price judgements about bonds in the marketplace.

It should be noted that in the case of an bond issuer selling through a competitive bond sale, there is less sensitivity to immediate price reporting than there is for the issuer selling at a negotiated sale. Some bond issuers who sell bonds exclusively or primarily at competitive sale are indifferent to the matter of "NRO"s and immediate price reporting.

It is the firm belief of our office that the competitive bond sale process is the best determinant of market price. For those bond sales which do not lend themselves to competitive sale (for various classic reasons) the bond issuer negotiating a sale must still look at the contemporary market, including all contemporary competitive sales, to understand the price movements occurring in the market and make a judgement about the value of the bonds being sold.

Transparency in over-the-counter markets requires the input and assessment of professional trading in a viable market where all the cards are on the table for everyone to see. Over the past several years, there appear to have been extended periods of time where the secondary market for municipal bonds depended almost exclusively on the new issue pricing in the primary market. This appears especially true during significant market price declines. In the immediate past three weeks, this interdependency of secondary market prices on primary new issue markets was again confirmed. It would appear that general secondary market activity came almost to a standstill and that traders were dependent on new issue pricing to assess both the bid side and the asked side of the market and to evaluate bonds held in inventory.

Apparent Reasons for "NRO" Price Reporting. There is no explanation for the deleterious effect of "NRO" reporting other than the fact that the practice conceals the price at which a transaction occurred from one or more participants in the market. Based on conversations with broker-dealers about this practice, it appears that there may be several theories for the practice of "NRO" reporting.

A common explanation of why prices may be reported as "NRO" is that there is no other convenient shorthand expression or jargon which says to the market, "These bonds have been sold and are not available." It is our understanding the "NRO" designation is normally used for maturities that have already been sold and are therefore unavailable to another dealer or investor. The fact that the bonds have been sold does not eliminate the importance of the bonds to the rest of the market; quite the opposite, the price at which an actual trade occurred is an important reference point for the rest of the market.

Probably the most frequent explanation for "NRO" pricing is that the bonds have been sold or committed as a result of "pre-sale" marketing effort by the broker-dealer. Because of the pre-sale marketing of competitive sale bonds, key institutional investors will make buy commitments at prices that reflect special terms. Those special terms presumably either require the underwriter to give up the concession component of the takedown to the investor (perhaps even most of the takedown), or establish a cheaper "pre-sale price" in return for the pre-sale commitment. The investor who makes a pre-sale commitment to purchase bonds is effectively reducing risk to the underwriting syndicate for their purchase of the competitive sale bond issue and indirectly assumes some of the underwriting risk of the competitive sale. We believe that these kinds of pre-sale marketing activities which are aimed at establishing prices for the bond issue are essential activities of underwriting syndicates and that price concessions made to investors in compensation for their risk assumption are appropriate. We do not, however, believe it is appropriate to withhold information about the actual price at which that trade occurred. It is our belief that such bonds should be noted as "sold, not available" but that the actual price at which the bonds were sold should be reported in the customary forums the market uses to show its bond offerings.

While it may be argued that withholding the pre-sale "discount" price at which bonds were sold may aid the orderly distribution and pricing of the remainder of the bond issue, the practice raises other obvious questions. Reporting the "discounted" or "concession" price of a pre-sale bond may cause the appearance of minor inversions in a yield curve. Presumably such inversions may create the appearance of a two-tiered market, causing other investors to demand the same lower price. Conversely it can be argued that market discipline may also emphasize the advantages to investors who make pre-sale commitments. The question regarding the true price at which a "discounted" or "concession" priced security sells, also raises questions with regard to the underwriter's certificate given to the issuer for arbitrage purposes. If the cheaper price is not being reported to the issuer, then the issuer is not being given the benefit of a higher arbitrage yield calculation in their tax certificate. It is our opinion that transparency and sunlight on these practices are the best answers to these questions. The market can figure it out. There should not be anything wrong with recognizing the value of a pre-sale order and reporting the price at which it was placed.

The practice of "NRO" reporting also leads to suspicions of less commendable practices. One practice that is often discussed, but apparently never documented, is the practice of "parking" bonds with an investor at a special price. In return for an unwritten commitment to repurchase the bonds from the investor in the near term, the broker-dealer is able to gain access to the bonds again after the primary market restriction period ends. The underwriter then marks the bonds up and sells them into the market. This office assumes that such practices are rare, but nevertheless we point out that "NRO" price reporting leaves other market participants in the dark and free to speculate about all kinds of practices, real or imagined!

In order for transparency to occur, the price at which "sold, not available" bonds traded must be reported at the same time other maturities in the same bond issue are reported.

<u>A Survey of "NRO" Price Reporting.</u> This office recently undertook a simple "windshield" survey of the prevalence of "NRO" pricing. The methodology for this survey was to review the bond sale results reported daily in *The Bond Buyer*. The total number of bond issues, the total number of maturities, and the total par of all reported bond sales were counted for both negotiated and competitive sales. A two-week period ending February 6, 1998 was compared

with a two-week period ending February 7, 1997. The results of this exercise are summarized below:

	1997 2-Week Period Ending 2/7/97	1998 2-Week Period Ending 2/6/1998
Negotiated Bond Sales		
Total # of Issues	134	251
Total Par Amount	$3.49 Billion	$7.69 Billion
Total # of Maturities	1,582	3,556
# of NRO Maturities	45	181
% of NRO Maturities	2.8%	5.1%
Competitive Bond Sales		
Total # of Issues	140	184
Total Par Amount	$1.91 Billion	$2.66 Billion
Total # of Maturities	1,682	2,604`
# of NRO Maturities	246	450
% of NRO Maturities	14.6%	17.3%

Some obvious conclusions can be drawn from this data:

- Use of "NRO" reporting is more prevalent for competitive bond sales than for negotiated bond sales.
- There is an indication of an increasing use of "NRO" reporting.
- If one believes, as we do, that the competitive bond sale is the best indicator of the primary market, then the data show that more than one out of every six prices that make up that portion of the primary market are obscured by "NRO" reporting.

This data does not examine and illustrate a further concern that the maturities being reported as "NRO" are frequently the largest maturities, the longest maturities, or are in some way the "keystone" maturities to the bond issue. This is a probable result of the pre-sale commitments that allow the underwriters to construct successful bids for the bonds, but it also means that the data being obscured probably had more "market significance" than the raw numbers illustrated by the above survey.

We are directly aware that a large percentage of smaller local bond issues are not reported at all, further obscuring bond pricing. This problem became apparent to our office recently when we analyzed pricing of negotiated and competitive school district bond sales in Wisconsin. We found that a large number of those issues were not reported publicly in the normal channels (TM3, Reuters, Down Jones Telerate, Bloomberg, *The Bond Buyer*) and that we were able to discover the issues even existed only through Securities Data Corporation reports and from Muni-View and other official statement data bases which probably originate with MSRB or NRMSIR filings.

<u>The Relationship to the Customer Transaction Reporting Program.</u> The information that will flow from the Customer Transaction Reporting Program will be useful to long-term historical tracking of bond pricing and market trends. That information will be useful to market participants in forming an opinion of the relative values of different bond issues and of the market values leading up to the day of a trade but it is, at best, "yesterday's news." To put it another way, it is not sensible to enter into listed stock trades or treasury bond transactions today based solely on the information that was reported in today's *Wall Street Journal.* The price data reported under the Customer Transaction Reporting Program will only have historical reference value in making a price judgement in the primary market. The expanded Customer Transaction Reporting Program provides "next day" access to a segment of bond prices, but not to the prices that were established five minutes ago in the primary market.

<u>Need for a New Rule.</u> We have reason to believe that this topic of "NRO" price reporting is one that is of interest to the Securities and Exchange Commission and that they will encourage consideration of a rule that addresses "NRO" pricing. It has been suggested that the best solution for all parties will be for the MSRB to address this matter promptly and responsively as an MSRB rule. We certainly believe that appropriate action by the MSRB will help forestall possibly more onerous action by the SEC.

Cost of a New Rule. We are aware that cost to the industry is always a matter of concern in considering any addition to, or modification of, MSRB rules. We believe that a properly crafted rule should impose no additional cost on the industry. The industry already bears, in one form or another, the cost of the ad hoc reporting system that exists today (again, TM3, Reuters, Dow Jones Telerate, Bloomberg, *The Bond Buyer*). A rule dealing with the "NRO" issue should not require any additional reporting, but rather should simply prohibit an "NRO" report.

We look forward to working with you on this matter.

Sincerely,

Frank R. Hoadley
Capital Finance Director

Cc: SEC
Dean Pope
Phyliss Currie
GFOA