



Vanguard[®]

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April 13, 2012

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street
Suite 600
Alexandria, VA 22314

Re: Request for Comment on Proposed Rule Amendments and
Interpretive Notice on Retail Order Periods (MSRB Notice 2012-13)

Dear Mr. Smith:

Vanguard¹ appreciates the opportunity to submit comments to the Municipal Securities Rulemaking Board (“MSRB”) on its Request for Comment on Proposed Rule Amendments and Interpretive Notice on Retail Order Periods (the “Proposal”). Vanguard is one of the mutual fund industry’s largest holders of municipal securities. As of March 31, 2012, Vanguard municipal bond and money market funds held approximately \$120 billion in municipal assets. We commend the MSRB for its efforts to address concerns regarding the retail order period as part of its new mandate to protect both investors in, and issuers of, municipal securities. Vanguard is a strong advocate of proposals that will improve investor access to primary offerings of municipal securities on the best available terms.

We believe, however, that the “retail order period,” as currently implemented in the municipal market and as contemplated by the Proposal, will prevent many *bona fide* retail investors from accessing this market. Retail mutual funds – which generally have very low investment criteria – generally may not submit orders during the retail order period, while “professional retail” separately-managed accounts (SMAs) – which may invest on behalf of individuals but carry higher investment minimums – typically may participate. This result contravenes the intent of the retail order period, which purports to allow retail investors to purchase bonds before institutional investors. Further, entire bond issues are often allocated to individual retail investors and SMAs prior to the submission of “institutional” orders by mutual funds and others, effectively limiting the access of millions of underlying retail investors to the primary market. This also results in issuers failing to see the total demand – retail and institutional – for their securities, which may result in incomplete price discovery. Because the Proposal leaves the determination of the definition of “retail” for the purposes of a particular offering exclusively to an issuer, we believe these issues will persist if the Proposal is adopted.

¹ As of March 31, 2012, Vanguard offered more than 170 U.S. mutual funds with approximately \$1.5 trillion in U.S. assets under management, serving approximately 9 million shareholders.

The ideal solution to the issues raised in the Proposal would be to permit all interested investors to submit orders for primary market municipal securities during a combined order period. This approach would fulfill the MSRB's mandate to protect investors and issuers by providing market access to the millions of retail shareholders of municipal mutual funds while assisting issuers in determining the best price for their securities. Alternatively, Vanguard supports the Proposal provided that the MSRB adopts a uniform definition of "retail" for the purposes of the retail order period. This definition should recognize the role of mutual funds as an investment vehicle for retail investors and allow for their participation on at least the same level of priority as "professional retail" purchasers such as SMAs. We believe that our proposed alternatives – a combined order period and a standard definition of "retail" – are consistent with the MSRB's mandate, as expanded under the Dodd-Frank Act, to protect both municipal issuers and investors.

A Combined Order Period Would Provide Retail Investors with Access to Municipal Securities and Provide Issuers with More Accurate Price Discovery

As noted, mutual funds currently may not place orders during a retail order period for primary offerings of municipal securities, even though their investors may be primarily retail. The Vanguard municipal bond and money market funds, for example, require a minimum investment of \$3,000. This low investment threshold provides hundreds of thousands of retail investors, who otherwise would not be able to place individual orders during a retail order period,² with access to a diversified portfolio of municipal securities. SMAs, on the other hand, frequently place orders during the retail order period even though the average investment minimum for an SMA is generally much higher. In many primary offerings, bonds are fully allocated during the retail order period, effectively shutting out retail investors that invest in municipal bonds via mutual funds.

In addition to shutting out these retail investors, the retail order period may prevent issuers from seeing the total demand for a particular bond. Many issuers hold retail order periods for a particular offering because they believe that filling a primary offering during this period will allow them to obtain the most advantageous pricing for their bonds. If all of the bonds are allocated to "retail" orders, however, an issuer will not benefit from knowing what the institutional level of demand is for that issue. We believe that discovery of the best price for an issue should result from an evaluation of the total market demand for that security. Otherwise, the potential economic benefit of the retail order period may inure only to intermediaries who may place retail orders for bonds which are then immediately sold to institutional investors such as mutual funds, a practice known as "flipping."

We believe that the ideal solution would be to consolidate all orders in a single order period with no priority given to a retail order. This would allow for the submission of orders by all prospective purchasers, including those retail investors that access the municipal market via mutual funds. In addition, issuers would be able to evaluate the total demand for the bond issue and price bonds accordingly. The advantages of a combined order period would be more likely to produce an outcome consistent with the MSRB's mandate to protect investors and issuers.

² In a primary offering, municipal securities are typically sold in minimum denominations of at least \$5,000. Frequently, the retail investors that invest in municipal bond and money market mutual funds do not have the necessary assets to purchase enough individual bond issues to assemble a diversified portfolio, or may be less sophisticated than the "professional retail" investors that invest through SMAs.

If the Retail Order Period is Retained, the MSRB Should Adopt a Uniform Definition of Retail That Accurately Reflects Retail Participants in Primary Offerings of Municipal Securities

Vanguard believes that the MSRB should define “retail” for purposes of the retail order period if the MSRB decides not to pursue a combined order period. If left to the exclusive determination of issuers, it is likely that the definition of retail will continue to vary from offering to offering. For example, some issuers currently define retail orders as those placed for the account of an individual, bank trust, or investment advisor with a maximum of \$1 million³, while other issuers may allow retail orders up to a maximum that differs from offering to offering. Further, issuers often have varying definitions for orders that may be submitted by eligible “Retail,” “National Retail,” “Professional Retail,” and other types of purchasers.

In order to avoid investor confusion and inconsistencies across the primary market, a standardized definition should be adopted. This standard definition of “retail” should, at a minimum, give equal priority to the orders of “true” individual retail investors, such as those that invest via mutual funds with low investment criteria, as orders submitted by “professional retail” purchasers, such as SMAs. If the MSRB does not adopt a standard definition of retail, and instead leaves this determination to the exclusive discretion of the issuer, then we would suggest that offerings of bonds during the retail order period be limited to par coupon bonds. If the issuer truly chooses to favor the retail investor order, the par coupon structure is the preferred structure for these investors. Issuing par coupon bonds during the retail order period may also discourage flipping, as institutional investors would be generally less interested in these bonds.

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We commend the MSRB for addressing concerns regarding the retail order period and appreciate the opportunity to comment on the Proposal. If you have any questions about Vanguard’s comments or would like any additional information, please contact me at 610-669-6345.

Sincerely,

/s/ Christopher Alwine

Christopher Alwine
Head of Municipal Bond Group
Vanguard

cc: Lynette Kelly, Executive Director
Municipal Securities Rulemaking Board

³ See, e.g., California Early Order Period, available at: <http://www.buycaliforniabonds.com/bcb/rop.asp>