



Municipal Securities Rulemaking Board

September 19, 2016

The Honorable Richard Shelby
Chairman, Senate Committee on Banking,
Housing & Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member, Senate Committee on
Banking, Housing & Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Jeb Hensarling
Chairman, House Committee on Financial
Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member, House Committee on
Financial Services
4340 O'Neill Federal Office Building
Washington, DC 20515

Re: Update on the Municipal Securities Rulemaking Board's Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Senators Shelby and Brown and Representatives Hensarling and Waters,

As Chair of the Municipal Securities Rulemaking Board (MSRB), the self-regulatory organization created by Congress in 1975 to oversee the U.S. municipal securities market, I am writing to update you regarding a major milestone for the MSRB. We have just concluded development of a core regulatory framework for municipal advisors, implementing a regime mandated by Congress under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). This letter details the new MSRB rules that comprise that framework. The Dodd-Frank Act also created the MSRB's municipal entity protection mandate, and this letter describes initiatives the MSRB has implemented to address this responsibility and to complement the new regulatory framework.¹

¹ A municipal entity is a state, political subdivision of a state, or municipal corporate instrumentality of a state, including (a) any agency, authority, or instrumentality of the state, political subdivision, or municipal corporate instrumentality; (b) any plan, program, or pool of assets sponsored or established by the state, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and (c) any other issuer of municipal securities.

Title IX of the Dodd-Frank Act, which covers investor protections and improvements to the regulation of securities intermediaries, granted the MSRB regulatory jurisdiction over municipal advisors. Title IX called for MSRB municipal advisor rules in fulfillment of several key objectives, including to:

- Promote fair dealing, the prevention of fraudulent and manipulative acts and practices, and the protection of investors, municipal entities, and obligated persons
- Prescribe means reasonably designed to prevent acts, practices, and courses of business that are not consistent with a municipal advisor's fiduciary duty to its municipal entity clients
- Prescribe professional standards
- Provide continuing education requirements
- Establish periodic coordination meetings with applicable regulatory organizations
- Provide for periodic examinations
- Provide for recordkeeping and record retention
- Provide for reasonable fees and charges necessary or appropriate to defray the costs of operating and administering the Board

On September 20, 2013, pursuant to Title IX of the Dodd-Frank Act, the U.S. Securities and Exchange Commission (SEC) adopted final rules for municipal advisor registration, which officially defined the term "municipal advisor" and created associated exemptions. Once defined, the MSRB analyzed both the Dodd-Frank Act and the SEC rule to determine how to propose to fulfill its new mandate to create a regulatory regime for municipal advisors. Since 2013, the MSRB, under the leadership of its Dodd-Frank Act mandated majority-public board of directors, transparently and with significant public comment developed rules and a professional qualification regime that address the key objectives of Section 15B of the Securities Exchange Act as amended by the Dodd-Frank Act.

The MSRB's rulemaking initiatives addressing each of these categories are detailed below.

Fair Dealing

The MSRB, in its effort to ensure that municipal entities and obligated persons² are treated honestly and fairly by their municipal financial professionals, extended the MSRB's existing fair dealing rule, applicable to underwriters, to municipal advisors and then developed additional

² An obligated person is any person (including the issuer) legally committed to support payment of all or part of an issue of municipal securities, other than certain unrelated providers of credit or liquidity enhancement. For example, the District of Columbia (issuer) may issue debt on behalf of Georgetown University (obligated person). Georgetown University, as the obligated person, is responsible for all repayment of debt.

guidance on the rule for underwriters. MSRB Rule G-17 requires municipal securities dealers and municipal advisors to deal fairly with all persons in the conduct of their municipal securities and municipal advisory activities and not engage in any deceptive, dishonest, or unfair practice. The reference in the rule to all persons includes municipal entities and obligated persons. The MSRB in an interpretive notice on Rule G-17 required underwriters to make appropriate disclosures to a municipal entity about their role in a municipal securities transaction, their compensation and any conflicts of interest in order to not misrepresent or omit any risks, potential benefits or other information that may be material to the municipal securities activities being undertaken by the underwriter. This guidance is a fundamental underpinning of the MSRB's broadened municipal entity protection efforts as mandated by the Dodd-Frank Act.

In order to address possible conflicts of interest in the municipal market, the MSRB extended MSRB Rule G-20 to municipal advisors, thereby creating common gift-giving standards and restrictions for all municipal financial professionals and addressing any material conflicts of interest that can arise from gift-giving in connection with municipal securities activities. Specifically, municipal advisors are now prohibited from giving gifts or gratuities to a person in excess of \$100 per year, if the gifts are in relation to the municipal securities activities or municipal advisory activities of the recipients' employer.

The establishment of pay-to-play regulations for municipal advisors is another key step in safeguarding the municipal market against real or perceived corruption. Amendments to the MSRB's longstanding Rule G-37, on political contributions and prohibitions on municipal securities business, became effective on August 17, 2016 and will curb, at a minimum, the appearance of *quid pro quo* corruption in the awarding of municipal advisory business and provide greater transparency regarding municipal advisors' political contributions. Consistent with the existing MSRB rule for dealers, the new regulations generally prohibit municipal advisors from engaging in municipal advisory business with municipal entities for two years if certain political contributions have been made to officials of those entities who can influence the awarding of business.

Fiduciary Duty and Supervision

In addition to establishing fair practice obligations for municipal advisors and reinforcing underwriters' obligations to disclose key information to municipal entities, the MSRB has implemented several rules to prevent acts and practices that are inconsistent with a municipal advisor's fiduciary duty to its municipal entity clients. MSRB Rule G-42, which went into effect on June 23, 2016, establishes core standards of conduct for non-solicitor municipal advisors consistent with the mandates of the Dodd-Frank Act and the fiduciary duty it imposes on municipal advisors in their relationships with municipal entity clients. The rule also provides guidance for municipal advisors on the duty of care owed in their relationships with obligated person clients, also consistent with the mandates of the Dodd-Frank Act. Key rule provisions require written documentation of the advisory relationship between the municipal advisor and

the client, including the scope of services to be performed and disclosure of any conflicts of interest or legal and disciplinary events; the specific fee structure associated with the engagement; and prohibition against acting as a principal in securities transactions, among other provisions. Rule G-42 also requires that a municipal advisor only make recommendations to clients that are suitable based on reasonable diligence performed by the municipal advisor, while requiring municipal advisors to municipal entity clients in particular to act in such clients' best interests.

New MSRB Rule G-44 establishes supervisory and compliance obligations for municipal advisor firms, essential functions that are fundamental to preventing securities law violations from taking place and promoting early detection and prompt remediation of violations if they do occur. Municipal advisors must now develop, implement and maintain supervisory procedures reasonably designed to ensure their municipal advisory activities comply with all regulatory requirements. It is important to the MSRB that each new municipal advisor rule accommodate the diversity of the municipal advisor population, including sole proprietor firms. For this reason, Rule G-44 follows a primarily principles-based approach to supervision and compliance, with each firm taking into consideration its size, organizational structure, nature and scope of municipal advisory activities and other factors in its approach to its supervision and compliance functions.

Professional Standards

The MSRB believes that the implementation of professional standards for municipal advisors is necessary to ensure that all municipal advisors are competent and qualified. The creation of a baseline test of competency and knowledge of applicable rules is an important step toward protecting the interests of municipal entities and obligated persons that rely on the advice of municipal advisors. Amended MSRB Rule G-3 defines two classifications of municipal advisor professionals, representative and principal. All municipal advisor representatives and principals are required to take and pass the Municipal Advisor Representative Examination (Series 50) to demonstrate the level of knowledge needed to be qualified to perform municipal advisory activities. A separate qualification exam for municipal advisor principals is currently in the development process. Rule G-3 also outlines requirements for continuing education, an additional area of regulation of municipal advisors addressed by the Dodd-Frank Act for which new rule amendments are to be proposed this fall.

Regulatory Coordination

As part of a deliberate focus on regulatory efficiency and to support ongoing regulatory coordination, the MSRB has enhanced its interaction with other regulators. While the MSRB is the principal regulator of the municipal securities market, it does not enforce its rules or conduct compliance examinations. The MSRB collaborates with the SEC in its oversight of the municipal market, and provides enforcement support to regulatory authorities that examine for compliance with and enforce MSRB rules, including FINRA and federal bank regulators. For

example, the MSRB frequently provides rule interpretations, training related to the municipal market and MSRB rules, and access to municipal market information through the MSRB's Regulator Web application in support of the examination and enforcement activities of these other regulatory authorities.

Examination

The MSRB, in conjunction with the SEC, provides for periodic examinations of municipal advisor firms. Pursuant to Dodd-Frank, the designated examining authority for municipal advisors is the SEC, which conducts examinations as it deems necessary or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of the Act as provided for pursuant to Section 17(b)(1) of the Act. The SEC has designated FINRA as the examining authority for municipal advisors that are also FINRA members in their capacity as broker-dealers. Through coordination and engagement with the SEC, MSRB staff conducts scheduled and frequent discussions with the SEC regarding its exam program to assess whether municipal advisors are being examined by the SEC on a periodic basis and to evaluate the effectiveness of the comprehensive regulatory framework the MSRB has developed for municipal advisors.

Recordkeeping

The MSRB's municipal advisor regulatory regime includes recordkeeping provisions and rules related to record retention. Under amended MSRB Rules G-8 and G-9, all municipal advisors are required to make, keep and retain records on general business proceedings, gifts and gratuities and written supervisory procedures, among other records.

Fees and Expenses

The Dodd-Frank Act allows for the MSRB to institute reasonable fees and charges to defray the costs and expenses of operating and administering the MSRB. MSRB operations are funded primarily by assessments and fees on regulated entities engaged in municipal securities and municipal advisory activities. Amended MSRB Rule A-12 requires registration by municipal advisors with the MSRB and requires new registrants to pay a \$300 annual fee per professional, in addition to a \$1,000 initial and \$1,000 annual fee paid by the regulated entity. As of September 2016, approximately 680 firms are registered as a municipal advisor with the MSRB and there were approximately 4,500 municipal advisor professionals associated with those firms. For fiscal year 2017, a projected 3.2 percent of the MSRB's revenues will be funded by municipal advisor fees. As needed, the MSRB conducts a holistic fee review to examine funding sources with the goal of ensuring long-term sustainability, achieving an equitable balance among regulated entities and a fair allocation of the costs of systems and services among other users and regulated entities.

Municipal Entity Protection

Through the enactment of the Dodd-Frank Act, Congress broadened the MSRB's original investor protection mandate to include the protection of municipal entities. The mandate to protect municipal entities is unique among federal securities regulators, reflecting the important role of municipal entities in the creation and maintenance of essential public service projects nationwide. Importantly, although the MSRB can and does receive information and disclosures from municipal entities for public dissemination, the Securities Exchange Act of 1934 does not authorize the MSRB to regulate issuers of municipal securities. Accordingly, the MSRB protects municipal entities through a focus on three mission-driven objectives. First, as described above, the MSRB develops rules for broker-dealers and municipal advisors that promote fair, efficient and transparent transactions and prevent fraudulent and manipulative acts and practices. Second, as detailed in the description of the MSRB's Electronic Municipal Market Access (EMMA[®]) website below, the MSRB advances transparency initiatives that collect and disseminate information about municipal bond underwritings and trades to help ensure that these transactions occur in compliance with MSRB rules. Third, through the market leadership initiatives, education and outreach activities described below, the MSRB assists municipal market stakeholders—municipal and regulated entities alike—in understanding the regulatory landscape and how MSRB rules may affect them.

EMMA Tools

The MSRB's EMMA website is the official source of municipal market data and disclosure information on virtually all municipal bonds. In the last few years, the MSRB has enhanced EMMA with free tools to help municipal entities, investors and other market participants monitor bond price information and access important disclosure documents. Users of the EMMA website now have access to expanded statistics on the municipal market, enhanced graphical display of historical trade data, and credit ratings from all major rating agencies.³ Recently, the MSRB launched the display of an economic calendar on EMMA to provide users with information about upcoming events, speeches and economic data releases that may impact the municipal market. The MSRB plans to enhance EMMA with the addition of third-party yield curves and a new issue calendar.

The MSRB has also developed a number of tools to assist the issuer community in complying with their disclosure obligations and communicating with investors. The MSRB believes that improved market transparency helps protect a municipal entity's ability to access the municipal market to raise capital, and that a primary driver of transparency is the timely disclosure of financial statements and material event notices. An email reminder tool on EMMA alerts municipal entities to approaching quarterly and annual financial disclosure filing deadlines. EMMA has also been updated to allow municipal entities to customize their issuer homepage to

³ Standard & Poor's Financial Services LLC, Moody's Investors Service, Inc., Fitch Ratings and Kroll Bond Rating Agency.

serve as a type of investor website, providing the marketplace easy access to consolidated information on trading activity, official statements and continuing disclosures.

Education and Outreach

The MSRB believes that inherent in our responsibility to adopt regulations and promote municipal market transparency is the responsibility to educate market participants on the progress and effect of these efforts. Since being vested with the duty of regulating municipal advisors, the MSRB has conducted considerable education and outreach to engage with the newly regulated municipal advisors, including soliciting feedback in the rulemaking process, conducting educational webinars and outreach events, and creating educational materials to assist in complying with the new rules. Specifically:

- Approximately 7,500 email subscribers receive municipal advisor-specific information from the MSRB on regulatory developments and resources.
- Since 2013, the MSRB has conducted 19 free webinars targeted to the municipal advisor community with over 9,500 webinar views, covering each municipal advisor rule, the process of registration with the SEC and MSRB, and information about the new Series 50 examination, among other topics.
- The MSRB has created a set of educational documents and compliance advisories to assist municipal advisors in understanding their regulatory obligations and the potential risks associated with a failure to implement adequate compliance controls.⁴

The development of the municipal advisor representative qualification examination is one example of the MSRB's successful efforts to engage the municipal advisor community. In 2014, as part of the Series 50 exam development process, approximately 900 MSRB-registered municipal advisor firms responded to a survey about their business activities and the day-to-day responsibilities of municipal advisory professionals. The survey responses assisted the MSRB in developing a professional qualifications exam that accurately reflects current industry practices, while providing an opportunity for the municipal advisor community to contribute its knowledge and expertise. When the MSRB offered the pilot exam to municipal advisors in early 2016, more than 1,800 individuals—representing over 40 percent of the municipal advisor representative population and 35 percent of municipal advisor firms throughout the country—registered to take the pilot exam. Because of the MSRB's extensive outreach to municipal advisors, the professional qualification exam reflects significant input and participation of municipal advisors.

In parallel with the educational support provided to regulated entities, the MSRB has been engaged in a national campaign to increase its outreach to state and local governments to raise

⁴ <http://www.msrb.org/Regulated-Entities/Resources.aspx>

awareness about resources for complying with disclosure requirements and communicating with investors. The campaign includes presentations at state and local government organization conferences, webinars, emails and related communications. Another important focus of the campaign is to assist municipal entities in understanding what they can expect from their municipal advisors under the new regulatory framework. To date, the MSRB has presented to over 4,000 issuer representatives in 34 states.

The MSRB recently released an expanded education program for municipal market participants focused on market fundamentals and MSRB rules. The expanded program, MuniEdProSM, includes on-demand education through the use of new digital tools, with the goal of reaching a broad and diverse population of market participants.

Conclusion

The \$3.7 trillion municipal securities market is vital to maintaining the nation's infrastructure and is essential to fostering both local and national economic growth. The MSRB has made rapid and transparent progress since the enactment of the Dodd-Frank Act in developing new rules that ensure that all regulated professionals operating in the municipal market conduct their work with integrity, fairness and transparency. New rules guard against unfair practices by municipal advisors and work to ensure that the professionals advising our state and local governments are qualified and are appropriately trained, licensed and educated. The MSRB has also advanced new education and outreach initiatives and market transparency tools since the enactment of the Dodd-Frank Act that support the objective to protect municipal entities and complement the new regulatory framework.

We remain committed to our mission to protect investors and promote a fair, efficient and transparent municipal market, and stand ready to serve as a resource to Congress. Do not hesitate to contact me or MSRB Executive Director Lynnette Kelly at 202-838-1500 with any questions or concerns.

Regards,

A handwritten signature in black ink, appearing to read "Nat Singer", with a stylized flourish at the end.

Nathaniel Singer
Chair, Municipal Securities Rulemaking Board