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[Rule G-8](#); [Rule G-9](#)

SEC Approves MSRB Rule G-44 on Supervisory and Compliance Obligations of Municipal Advisors, and Amendments to MSRB Rules G-8 and G-9

Overview

The Municipal Securities Rulemaking Board (MSRB) received approval from the Securities and Exchange Commission (SEC or Commission) on October 23, 2014 to adopt its first dedicated rule for municipal advisors, MSRB Rule G-44, on supervisory and compliance obligations of municipal advisors, and related amendments to MSRB Rule G-8, on books and records to be made by brokers, dealers and municipal securities dealers, and MSRB Rule G-9, on preservation of records.¹

The MSRB, in the exercise of authority granted by the Dodd-Frank Wall Street Reform and Consumer Protection Act, is currently developing a comprehensive regulatory framework for municipal advisors. A significant element of that regulatory framework is Rule G-44, which establishes supervisory and compliance obligations of municipal advisors when engaging in municipal advisory activities. Rule G-44 utilizes a primarily principles-based approach to supervision and compliance in order to, among other things, accommodate the diversity of the municipal advisor population, including small and single-person entities. Supervision and compliance functions are fundamental to preventing securities law violations from occurring, promote early detection and prompt remediation of violations if they do occur, and are complementary to the enforcement programs of other appropriate regulatory organizations designed to deter violations of securities laws by imposing penalties for violations after they occur. The compliance policies and supervisory procedures established by

¹ See Exchange Act Release No. 73415 (Oct. 23, 2014), File No. SR-MSRB-2014-06 (Jul. 24, 2014).



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municipal advisors pursuant to this rule will lay the foundation for and promote compliance with all other applicable rules. Rule G-44 is accompanied by amendments to Rules G-8 and G-9 to establish fundamental books-and-records requirements for municipal advisors, including those related to their supervisory and compliance obligations.

The rule changes will become effective on April 23, 2015, except for Rule G-44(d), which will become effective on April 23, 2016. Questions concerning this Notice may be directed to Michael L. Post, Deputy General Counsel, or Carl E. Tugberk, Assistant General Counsel, at 703-797-6600.

Summary of Rule Changes

Rule G-44 on Supervisory and Compliance Obligations of Municipal Advisors

Rule G-44 follows a widely-accepted model in the securities industry, consisting of a reasonably-designed supervisory system complemented by the designation of a chief compliance officer (“CCO”).

Supervisory System

Rule G-44(a) is the core provision of the new rule, which requires all municipal advisors to establish, implement and maintain a system to supervise their municipal advisory activities and those of their associated persons that is reasonably designed to achieve compliance with all applicable securities laws and regulations, including applicable MSRB rules (defined as “applicable rules”). Paragraph (a) specifies that final responsibility for proper supervision rests with the municipal advisor. Subparagraph (a)(i) requires the establishment, implementation, maintenance and enforcement of written supervisory procedures reasonably designed to achieve compliance with applicable rules. Paragraph .01 of the Supplementary Material explains that municipal advisors may tailor their supervisory procedures to, among other things, their size, particular business model and structure, even accommodating firms with associated persons who may be permitted under all applicable law to supervise their own activities. Paragraph .02 of the Supplementary Material emphasizes how the rule affords flexibility to small municipal advisor firms, including those with only one associated person. Rule G-44(a)(i) also specifies requirements to promptly amend supervisory procedures to reflect changes in applicable rules and, as changes occur in the municipal advisor’s supervisory system, to promptly communicate the procedures and amendments to the municipal advisor’s relevant associated persons.

Subparagraph (a)(ii) requires municipal advisors to designate one or more municipal advisor principals to be responsible for the supervision required by the rule. Paragraph .03 of the Supplementary Material specifies the authority and specific qualifications required for municipal advisor principals designated as responsible for supervisory functions. According to the rule, they must have the authority to carry out the supervision for which they are responsible, including the authority to implement the municipal advisor's established written supervisory procedures and take any other action necessary to fulfill their responsibilities. They also must have sufficient knowledge, experience and training to understand and effectively discharge their supervisory responsibilities.² This paragraph also specifies that, even if not designated as a supervisory principal, whether a person has responsibility for supervision under the rule would depend on whether, under the facts and circumstances of a particular case, the person has the requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue.

Compliance Processes

Paragraph (b) of Rule G-44 requires municipal advisors to implement processes to establish, maintain, review, test and modify written compliance policies and supervisory procedures. Rule G-44(b) specifies that the reviews of compliance policies and supervisory procedures must be conducted at least annually. Paragraph .04 of the Supplementary Material provides, however, that municipal advisors should consider the need, in order to comply with all of the other requirements of the rule, for more frequent reviews. This paragraph also provides guidance on what, at a minimum, municipal advisors should consider during their reviews of compliance policies and supervisory procedures. These considerations include any compliance matters that arose since the previous review, any changes in municipal advisory activities and any changes in applicable law.

Chief Compliance Officer

Rule G-44(c) requires municipal advisors to designate one individual as their CCO. Paragraph .05 of the Supplementary Material explains the role of a CCO

² The MSRB intends to propose amendments to MSRB Rules G-2 and G-3 to create the "municipal advisor principal" classification, define the term and require qualification in accordance with MSRB rules. The MSRB expects those changes to become effective well in advance of the implementation dates of this rule change. Although the MSRB does not expect a municipal advisor principal qualifications examination to be in place by the time of the implementation dates of this rule change, the MSRB may develop such an examination in the future.

and the importance of that role. Specifically, a CCO is a primary advisor to the municipal advisor on its overall compliance scheme and the policies and procedures that the municipal advisor adopts in order to comply with applicable law. This paragraph further explains that the CCO can be a firm employee or a person external to the firm. However, if external to the firm, the person must have the appropriate competence, and the municipal advisor retains ultimate responsibility for its compliance obligations. This approach to the CCO function gives municipal advisors the option to outsource the CCO role and is consistent with the approach applicable to investment advisers under the Advisers Act.³

Paragraph .06 of the Supplementary Material specifies that the CCO, and any compliance officers that report to the CCO, shall have responsibility for and perform the compliance functions required by Rule G-44. Paragraph .07 of the Supplementary Material provides that a municipal advisor's CCO may hold any other position within the municipal advisor, including senior management positions, so long as the person can discharge the duties of CCO in light of all of the responsibilities of any other positions. This guidance is especially relevant to small municipal advisors, including sole proprietorships and other one-person entities. It makes clear that a single individual may, for example, serve under appropriate circumstances as CEO, supervisory principal and CCO. In addition, as discussed above, the CCO may be external to the firm, such as an outside consultant.

Annual Certification

Rule G-44(d) requires municipal advisors to have their chief executive officer(s) ("CEO") (or equivalent officer(s)) annually certify in writing that the municipal advisor has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable rules. FINRA member firms that also are municipal advisors are already required under FINRA Rule 3130 to make annually a substantially similar certification with respect to applicable federal securities laws and regulations, including MSRB rules. In light of this existing FINRA requirement, Rule G-44(d) provides for an exception from the annual certification requirement for municipal advisors that are subject to a substantially similar FINRA requirement. Paragraph .08 of the Supplementary Material provides that the execution of the certification and any consultation rendered in connection with the certification does not by itself establish business line responsibility.

³ See Section 202(25) of the Advisers Act, 15 U.S.C. 80b-2(25), and Rule 206(4)-7, 17 CFR § 275.206(4)-7.

Requiring each firm's CEO(s) (or equivalent officer(s)) to provide an annual certification should help ensure that compliance processes are given sufficient attention at the highest levels of management and should help promote compliance. The annual certification requirement should also foster discussion between compliance personnel and upper management for many firms, as it creates accountability for, and incentivizes, the CEO(s) (or equivalent officer(s)) to ensure that the certification is truthful and otherwise satisfies Rule G-44(d). Additionally, the annual certification requirement should help ensure that municipal advisors have in place a compliance framework that should allow them to adapt compliance efforts to an evolving business and regulatory environment, and promote prompt maintenance and modification of compliance programs, which should result in more robust written supervisory procedures that should promote compliance with all applicable rules.

Exemption for Federally-Regulated Banks

Rule G-44(e) provides an exemption for banks engaging in municipal advisory activities in the exercise of bank fiduciary powers from Rule G-44 and the related books and records requirements. To use the exemption, the municipal advisor must certify in writing annually that it is, with respect to those activities, subject to federal supervisory and compliance obligations and books and record requirements that are substantially equivalent to the supervisory and compliance obligations in Rule G-44 and the books and records requirements of Rule G-8(h)(v)(A)-(E). The ability to so certify and utilize this exemption is provided because it is unnecessary for a municipal advisor to comply with each of the other provisions of Rule G-44 if the municipal advisor is subject to federal supervisory and compliance obligations as part of the bank regulatory regime that are substantially equivalent to those of Rule G-44.

Rule G-8, on Books and Records to Be Made by Brokers, Dealers and Municipal Securities Dealers, and Rule G-9, on Preservation of Records

The amendments to Rules G-8⁴ and G-9 are the first revisions to those rules to address the books and records that must be made and preserved by municipal advisors registered or required to be registered with the SEC, and they should promote compliance and facilitate enforcement of Rule G-44,

⁴ Amended Rule G-8(h) includes reserved subparagraphs (ii) - (iv) for books and records provisions that the MSRB may propose in relation to other rules for municipal advisors. The MSRB will make conforming changes to Rule G-44 as appropriate depending on relevant future rulemaking actions by the MSRB and SEC.

other MSRB rules, and other applicable securities laws and regulations. As a fundamental element, new Rule G-8(h)(i) requires each municipal advisor to keep all of the general business records described in Exchange Act Rule 15Ba1-8(a)(1)-(8). New Rule G-8(h)(v) requires each municipal advisor to make and keep records related to its supervisory and compliance obligations.

Amended Rule G-9 requires each municipal advisor to preserve the books and records described in Rule G-8(h), including records related to the municipal advisor's supervisory and compliance obligations, for a period of not less than five years. This five-year preservation requirement is consistent with the requirement of Exchange Act Rule 15Ba1-8 (on books and records to be made and maintained by municipal advisors).⁵ New subsection (h) to Rule G-9 requires, however, that records of the designations of persons responsible for supervision and designations of persons as CCO be preserved for the period of designation of each person designated and for at least six years following any change in such designation. This longer, six-year preservation requirement is supported by, among other things, the importance of such documents in later ascertaining the identity of responsible persons during particular periods of time, including for purposes of examination and enforcement. Moreover, it is consistent with the current provisions of Rule G-9 for records of similar designations by brokers, dealers and municipal securities dealers.

The amendments to Rule G-9(e) and (k) expressly provide that municipal advisors may retain records using electronic storage media or by other similar medium of record retention, subject to the retrieval and reproduction requirements of Rule G-9. The allowance for this means of compliance is generally applicable, so as to expressly accommodate the use of electronic storage media by dealers as well as municipal advisors. New paragraph (k) provides that, whenever a record is preserved by a municipal advisor on electronic storage media, if the manner of storage complies with Exchange Act Rule 15Ba1-8(d),⁶ it will be deemed to be preserved in a manner that is in compliance with the requirements of Rule G-9. This provision gives municipal advisors the choice to comply with either the SEC's or the MSRB's preservation requirements.

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⁵ See 17 CFR § 240.15Ba1-8(b)(1).

⁶ 17 CFR § 240.15Ba1-8(d).

Text of Amendments⁷

Rule G-44: Supervisory and Compliance Obligations of Municipal Advisors

(a) *Supervisory System.* Each municipal advisor shall establish, implement, and maintain a system to supervise the municipal advisory activities of the municipal advisor and its associated persons that is reasonably designed to achieve compliance with applicable securities laws and regulations, including applicable Board rules (“applicable rules”). Final responsibility for proper supervision shall rest with the municipal advisor. A municipal advisor’s supervisory system shall provide, at a minimum, for the following:

(i) *Written Supervisory Procedures.* The establishment, implementation, maintenance and enforcement of written supervisory procedures that are reasonably designed to ensure that the conduct of the municipal advisory activities of the municipal advisor and its associated persons are in compliance with applicable rules. The written supervisory procedures shall be promptly amended to reflect changes in applicable rules and as changes occur in the municipal advisor’s supervisory system, and such procedures and amendments shall be promptly communicated to all associated persons to whom they are relevant based on their activities and responsibilities.

(ii) *Appropriate Principal.* The designation of one or more municipal advisory principals to be responsible for the supervision required by this rule.

(b) *Compliance Processes.* Each municipal advisor shall have in place and implement processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable rules, and shall conduct, no less frequently than annually, a review of the compliance policies and supervisory procedures.

(c) *Chief Compliance Officer.* Each municipal advisor shall designate one individual to serve as its chief compliance officer.

(d) *Annual Certification.* Each municipal advisor shall have its chief executive officer(s) (or equivalent officer(s)) certify in writing annually that the municipal advisor has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable rules. This requirement, however, shall not apply to municipal advisors that are subject to a substantially similar certification requirement of Financial Industry Regulatory Authority with respect to all applicable rules.

(e) *Exemption for Federally Regulated Banks.* A municipal advisor that is a bank or separately identifiable department or division of a bank as defined in Securities Exchange Act Rule 15Ba1-1(d)(4) shall, to the extent it engages in municipal advisory activities in the exercise of any fiduciary powers as defined in 12 C.F.R. Section 9.2(g) or substantially identical powers, be exempt from this rule and Rule G-8(h)(v)(A)-

⁷ Underlining indicates new language; strikethrough denotes deletions.

(E) if such municipal advisor certifies in writing annually that it is, with respect to such activities, subject to federal supervisory and compliance obligations and books and records requirements that are substantially equivalent to the supervisory and compliance obligations of this rule and the books and records requirements of Rule G-8(h)(v)(A)-(E).

(f) *Definition.* “Municipal advisor,” for purposes of this rule, shall mean a person registered or required to be registered as a municipal advisor under section 15B of the Act and rules and regulations thereunder.

---Supplementary Material:

.01 Written Supervisory Procedures. A municipal advisor’s written supervisory procedures shall take into consideration, among other things, the advisor’s size; organizational structure; nature and scope of municipal advisory activities; number of offices; the disciplinary and legal history of its associated persons; the likelihood that associated persons may be engaged in relevant outside business activities; and any indicators of irregularities or misconduct (i.e., “red flags”). In the case of a municipal advisor with any associated persons permitted under all applicable law to supervise their own activities, the written supervisory procedures must address the manner in which, in the absence of separate supervisory personnel, such procedures are nevertheless reasonably designed to achieve compliance with applicable rules.

.02 Small Municipal Advisors. A municipal advisor with few personnel, or even only one associated person, can have a sufficient supervisory system under this rule. The rule allows the designation of one person to be responsible for supervision, and allows the tailoring of written supervisory procedures based on, among other things, an advisor’s size.

.03 Appropriate Principal. Designated supervisory principals must be vested with the authority to carry out the supervision for which they are responsible and have sufficient knowledge, experience and training to understand and effectively discharge their responsibilities. They also must have the authority to implement the established written supervisory procedures and take any other action necessary to fulfill their responsibilities. Even if not so designated, whether a person has responsibility for supervision under this rule depends on whether, under the facts and circumstances of a particular case, that person has the requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue.

.04 Review of Compliance Policies and Supervisory Procedures. The reviews under paragraph (b) of this rule should, at a minimum, consider any compliance matters that arose since the previous review, any changes in the municipal advisory activities of the municipal advisor or its affiliates, and any changes in applicable rules that might suggest a need to revise the written compliance policies or supervisory procedures. Although paragraph (b) specifically requires reviews to be conducted at least annually, municipal advisors should consider the need, in order to comply with all of the other requirements of this rule, for interim reviews.

.05 Chief Compliance Officer. A chief compliance officer has a unique and integral role in the administration of a municipal advisor’s compliance processes. A chief compliance officer is a primary

advisor to the municipal advisor on its overall compliance scheme and the policies and procedures that the municipal advisor adopts in order to comply with applicable rules. To fulfill this role, a chief compliance officer should have competence in the process of (1) gaining an understanding of the services and activities that need to be the subject of written compliance policies and written supervisory procedures; (2) identifying the applicable rules and standards of conduct pertaining to such services and activities based on experience and/or consultation with others; (3) developing, or advising other business persons charged with the obligation to develop, policies and procedures that are reasonably designed to achieve compliance with applicable rules and standards of conduct; and (4) developing programs to test compliance with the municipal advisor's policies and procedures. It is the intention of this rule to foster regular and significant interaction between senior management and the chief compliance officer regarding the municipal advisor's comprehensive compliance program. The chief compliance officer may be a principal of the firm or a non-employee of the firm. If a non-employee, then the person designated as chief compliance officer must have the competence described above and the municipal advisor retains ultimate responsibility for its compliance obligations.

.06 Responsibility for Compliance Functions. The chief compliance officer, and any compliance officers that report to the chief compliance officer, shall have responsibility for and perform the compliance functions contemplated by this rule. Nothing in this rule, however, is intended to limit or discourage the participation by any of the employees of the municipal advisor in any aspect of the municipal advisor's compliance program.

.07 Ability of Chief Compliance Officer to Hold Other Positions. The requirement to designate a chief compliance officer does not preclude that person from holding any other positions within the municipal advisor, including serving in any position in senior management or being designated as a supervisory principal, provided that person can discharge the duties of chief compliance officer in light of all of the responsibilities of any other positions.

.08 Effect of Annual Certification on Business Line Responsibility. The Board recognizes that supervisors with business line responsibility are accountable for the discharge of a municipal advisor's compliance policies and written supervisory procedures. The signatory to the certification required by this rule is certifying only as to having processes in place to establish, maintain, review, test and modify the municipal advisor's written compliance and supervisory policies and procedures and the execution of this certification and any consultation rendered in connection with such certification does not by itself establish business line responsibility.

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Rule G-8: Books and Records to be Made by Brokers, Dealers, ~~and~~ Municipal Securities Dealers, and Municipal Advisors

(a) - (g) No change.

(h) *Municipal Advisor Records.* Every municipal advisor that is registered or required to be registered under section 15B of the Act and the rules and regulations thereunder shall make and keep current the following books and records:

(i) *General Business Records.* All books and records described in Rule 15Ba1-8(a)(1)-(8) under the Act.

(ii) Reserved.

(iii) Reserved.

(iv) Reserved.

(v) *Records Concerning Compliance with Rule G-44.*

(A) The written supervisory procedures required by Rule G-44(a)(i);

(B) A record of all designations of persons responsible for supervision as required by Rule G-44(a)(ii);

(C) Records of the reviews of written compliance policies and written supervisory procedures as required by Rule G-44(a) and (b);

(D) A record of all designations of persons as chief compliance officer as required by Rule G-44(c);

(E) The annual certifications as to compliance processes required by Rule G-44(d); and

(F) Any certifications made as to substantially equivalent supervisory and compliance obligations and books and records requirements pursuant to Rule G-44(e).

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Rule G-9: Preservation of Records

(a) - (d) No change.

(e) *Method of Record Retention.* Whenever a record is required to be preserved by this rule, such record may be retained either as an original or as a copy or other reproduction thereof, or on microfilm, ~~electronic or magnetic tape~~, electronic storage media, or by the other similar medium of record retention, provided that such broker, dealer, ~~or municipal securities dealer~~, or municipal advisor shall have available adequate facilities for ready retrieval and inspection of any such record and for production of easily readable facsimile copies thereof and, in the case of records retained on microfilm, ~~electronic or magnetic~~

tape, electronic storage media, or other similar medium of record retention, duplicates of such records shall be stored separately from each other for the periods of time required by this rule.

(f) *Effect of Lapse of Registration.* The requirements of this rule shall continue to apply, for the periods of time specified, to any broker, dealer, ~~or~~ municipal securities dealer, or municipal advisor which ceases to be registered with the Commission, except in the event a successor registrant shall undertake to maintain and preserve the books and records described herein for the required periods of time.

(g) No change.

(h) *Municipal Advisor Records.* Every municipal advisor shall preserve the books and records described in Rule G-8(h) for a period of not less than five years, provided that the records described in Rule G-8(h)(v)(B) and (D) shall be preserved for the period of designation of each person designated and for at least six years following any change in such designation.

(i) *Municipal Advisor Records Related to Formation and Cessation of its Business.* Every municipal advisor shall comply with the provisions of Rule 15Ba1-8(b)(2) and (c) under the Act.

(j) *Records of Non-Resident Municipal Advisors.* Every non-resident municipal advisor shall comply with the provisions of Rule 15Ba1-8(f) under the Act.

(k) *Electronic Storage of Municipal Advisor Records Permitted.* Whenever a record is required to be preserved by this rule by a municipal advisor, such record may be preserved on electronic storage media in accordance with section (e). Electronic preservation of any record in a manner that complies with Rule 15Ba1-8(d) under the Act will be deemed to be in compliance with the requirements of this rule.