

2015-18

Publication Date

October 5, 2015

Stakeholders

Municipal Securities
Dealers, Municipal
Advisors, Issuers,
Investors, General
Public

Notice Type

Request for Comment

Comment Deadline

November 19, 2015

Category

Administration

Affected Rules

[Rule A-3](#)

Request for Comment on Draft Amendments to MSRB Rule A-3 to Lengthen the Term of Board Member Service

Overview

The Municipal Securities Rulemaking Board (MSRB) is seeking comment on draft amendments to MSRB Rule A-3, on membership on the Board of Directors (Board), to lengthen the term of Board member service from three years to four years. The draft amendments are primarily designed to improve the continuity and institutional knowledge of the Board from year to year, while retaining the benefits of the regular addition of new members.

Comments should be submitted no later than November 19, 2015, and may be submitted in electronic or paper form. [Comments may be submitted electronically by clicking here.](#) Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314. All comments will be available for public inspection on the MSRB's website.¹

Questions about this notice should be directed to Robert Fippinger, Chief Legal Officer, or Carl E. Tugberk, Assistant General Counsel, at 703-797-6600.

Background

Many general, and some more detailed, aspects of the Board's composition are set forth in the Securities Exchange Act of 1934 ("Exchange Act" or

¹ Comments are posted on the MSRB's website without change. Personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.



Receive emails about MSRB
regulatory notices.

“Act”).² It categorizes the members of the Board in two broad groups: individuals who must be associated with a broker, dealer or municipal securities dealer (“dealer”) or municipal advisor (collectively, “Regulated Representatives”), and individuals who must be independent of any dealer or municipal advisor (“Public Representatives”).³ The Act then specifies that the number of Public Representatives must at all times exceed the number of Regulated Representatives,⁴ and sets minimum requirements for certain types of individuals to serve in the two groups.⁵

At the same time, Congress delegated authority to the MSRB to determine many aspects of Board composition by rule, including such important aspects as the size of the Board and the length of the term of Board member service.⁶ Currently, the Board is divided into three seven-member classes that serve three-year, staggered terms.⁷ Under this framework, total Board tenure typically is no more than three years because Board members may only serve consecutive terms under two limited scenarios: (1) by invitation from, and due to special circumstances as determined by, the Board; or (2) having filled a vacancy and, therefore, having served only a partial term.⁸

The optimal term length for board membership of an organization depends to a great extent upon the particular characteristics of the organization, including the nature of its mission and its activities. The MSRB is the self-regulatory organization (SRO) created by Congress to establish regulation for the \$3.7 trillion municipal securities market, including rules governing the municipal securities activities of dealers and the municipal advisory activities of municipal advisors. The MSRB’s mission is to protect municipal entities, obligated persons, investors and the public interest, and to promote a fair

² See 15 U.S.C. 78o-4(b)(1). Rule A-3 further establishes the Board’s composition and sets its size at 21 members.

³ See 15 U.S.C. 78o-4(b)(1); MSRB Rule A-3(a)(i)-(ii).

⁴ See 15 U.S.C. 78o-4(b)(2)(B)(i).

⁵ See 15 U.S.C. 78o-4(b)(1); MSRB Rule A-3(a).

⁶ The Act provides that “[t]he members of the Board shall serve as members for a term of 3 years or for such other terms as specified by rules of the Board,” 15 U.S.C. 78o-4(b)(1), and requires the rules of the Board to “specify the length or lengths of terms members shall serve” 15 U.S.C. 78o-4(b)(2)(B)(ii).

⁷ See MSRB Rule A-3(b)(i).

⁸ *Id.*

and efficient municipal securities market. The MSRB fulfills this mission primarily by regulating dealers and municipal advisors, providing market transparency through its Electronic Municipal Market Access (EMMA[®]) website⁹ and conducting market leadership, outreach and education.

Against the backdrop of the nature of the mission and activities of an organization, the optimal term length for board member service is necessarily a balance among numerous competing interests, such as the interests in continuity, institutional knowledge and membership experience, on the one hand, and the interest in the addition of new perspectives, on the other. To date, the MSRB has aimed to achieve this balance using a Board member term of three years. In July 2015, the MSRB published a request for comment that raised the issue, at a conceptual level, of whether it should modify the length of Board member service.¹⁰ After further deliberation and carefully considering the comments, the MSRB now believes that the desired balance could be better achieved using an incrementally longer Board member term of four years.

Based on its experience and the views repeatedly expressed by former Board members, the Board believes that members are capable of making significantly increasing contributions with each year that they become more fully acclimated to the role and work of the MSRB.¹¹ The existence of such a multi-year “learning curve” is consistent with views expressed in a survey conducted by the Society of Corporate Secretaries and Governance

⁹ EMMA[®] is a registered trademark of the MSRB.

¹⁰ [Request for Comment on Draft Amendments and Other Issues Related to MSRB Rule A-3, MSRB Notice 2015-08 \(Jun. 11, 2015\)](#) (Initial Request for Comment). The MSRB received fifteen comment letters in response to the Initial Request for Comment, *available at* <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2015/2015-08.aspx?c=1>, all of which were informative in developing the draft amendments.

¹¹ The current, standard three-year term of Board member service is significantly shorter than the average tenure of over 8 years that studies have shown for members of other boards. *See* Spencer Stuart Board Index 2014, 5, *available at* <https://www.spencerstuart.com/~media/pdf%20files/research%20and%20insight%20pdfs/ssbi2014web14nov2014.pdf%20target>; Governance Minutes by the Society of Corporate Secretaries and Governance Professionals – Director Tenure (February 26, 2014), *available at* <http://main.governanceprofessionals.org/governanceprofessionals/memberresources/resources/viewdocument/?DocumentKey=37b09de5-7404-4eab-bc70-10741cbf7138> (stating that average board member tenure is 8-10 years and that board members typically experience a 3-4 year learning curve) (Governance Minutes).

Professionals of board members across a range of industries.¹² A number of studies suggest that longer board member tenures—to a point—are associated with superior governance.¹³ Overall, based on its experience and expertise regarding its mission and activities, the MSRB believes that allowing members to serve on the Board for a fourth year would improve the continuity and institutional knowledge of the Board from year to year, as well as its overall efficiency and effectiveness due to the collective value of retaining several members who possess additional knowledge and experience from their service as MSRB Board members.

Greater continuity and institutional knowledge is particularly important for the MSRB rulemaking process. This process, particularly for rules that are complex or address unique problems, frequently spans multiple years from conception to full implementation.¹⁴ Even for rulemaking initiatives that can be completed in relatively less time, Board members have noted frequently that they are often able to engage more fully and effectively in the process after they have gained experience with the organization and have deeper knowledge of other, related rulemaking activities.

The MSRB believes that the draft amendments would ensure greater continuity and institutional knowledge from year to year, particularly through the rulemaking process, and increase overall efficiency, while maintaining the benefits of having a significant number of new Board members join the organization each year.

Draft Amendments to Rule A-3

The draft amendments would lengthen the term of Board member service from three years to four years. To facilitate the proposed four-year term length, the draft amendments would increase the number of Board classes

¹² See Governance Minutes, *supra* note 11.

¹³ See, e.g., Nikos Vafeas, *Length of Board Tenure and Outside Director Independence*, 30 J. OF BUS. FIN. & ACCT. 1043 (2003); Lucian Arye Bebchuck, Jesse M. Fried, and David I. Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. OF CHI. L. REV. 751 (2002); Mark S. Beasley, *An Empirical Analysis of the Relation Between the Board of Director Composition and Financial Statement Fraud*, 71 THE ACCT. REV., 443 (1996).

¹⁴ For example, the MSRB began its current rulemaking initiative for Rule G-42, to establish core standards and duties for municipal advisors, in the fall of 2013, and the proposal remains under SEC consideration whether to be approved (and then would have a six-month implementation period). The MSRB's ongoing initiative for Rule G-18, to establish the first best-execution rule for transactions in municipal securities, began as early as the spring of 2013 and will continue to be in an implementation period into 2016.

and adjust their sizes. Finally, the draft amendments would provide for a transition to these changes in an expeditious but minimally disruptive manner.

The primary draft amendments are to Rule A-3(b)(i). They would increase the Board member term length from three years to four years and the number of Board classes from three to four—three classes comprised of five members and one class comprised of six. The changes in the number of classes and their sizes would ensure that the MSRB nominates and elects new members every year, maintains classes that are as evenly distributed in size as possible, and ensures that the composition of the Board always satisfies statutorily-required position allocations,¹⁵ while resulting in a consistent and manageable rate of turnover from year to year. As required by Rule A-3(b)(i), the classes would continue to be as evenly divided in number as possible between Public Representatives and Regulated Representatives.

While maintaining the existing requirement in Rule A-3(a)(ii)(3) that, for the Board as a whole, "at least one, and not less than 30 percent of the total number of [R]egulated [R]epresentatives, shall be associated with and representative of municipal advisors and shall not be associated with a broker, dealer or municipal securities dealer," the draft amendments would eliminate the additional requirement that there be at least one municipal advisor representative per class that is not associated with a dealer ("non-dealer municipal advisor").¹⁶ Because the draft amendments would result in four classes, not eliminating this requirement would create an unintended obligation that the Board always include four non-dealer municipal advisors, thus potentially diminishing representation of other regulated entities. Nothing in this change would reduce the representation of municipal advisors nor would it prohibit the MSRB from deciding to include more than three non-dealer municipal advisors on the Board. All other provisions in Rule A-3(b)(i), including the special circumstances exception to a Board member serving consecutive terms, would remain unchanged.

To effectuate the changes in term length and the number and size of classes, the MSRB is proposing a transition plan to be contained in Rule A-3(h)(i).¹⁷

¹⁵ See note 5 *supra*.

¹⁶ See MSRB Rule A-3(b)(i).

¹⁷ Existing Rule A-3(h)(i) is now an obsolete provision that was created following the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to transition the Board to be in compliance with the requirements of that law.

Under the transition plan, each Board member, who was elected prior to, and whose term ends on or after the end of, the MSRB's fiscal year 2016,¹⁸ could be considered for a term extension not exceeding one year. This process would occur over fiscal years 2017, 2018 and 2019. The transition would proceed as follows: (1) one Public Representative from the Board class of 2016 (*i.e.*, members who began a three-year term on October 1, 2013) would receive a one-year extension and six new members would join the Board; (2) one Public and two Regulated Representatives from the Board class of 2017 (*i.e.*, members who began a three-year term on October 1, 2014) each would receive a one-year extension and five new members would join the Board; and (3) three Public and two Regulated Representatives from the Board class of 2018 (*i.e.*, members who will begin a three-year term on October 1, 2015) each would receive a one-year extension and five new members would join the Board. The draft amendments would provide that Board members would be nominated for the term extensions by a special nominating committee comprised only of Board members not being considered for extensions, and then the Board would vote on each proposed term extension.¹⁹ The selection of Board members whose terms would be extended would be consistent with the statutorily-required compositional requirements of the Board,²⁰ and the Board would continue to consist of 21 members with a majority of Public Representatives.²¹ In fiscal year 2020, no further extensions would be required and five new members would join the Board, completing the transition to four classes. From that point forward, the Board would repeatedly nominate and elect classes in the sequence of six, five, five, and five members. While there are numerous possible combinations of the number of Board classes and the number of members in each class, the MSRB believes this specific combination would achieve the transition expeditiously and efficiently while minimizing any disruption from the changes.

¹⁸ The MSRB's fiscal year commences on October 1 of a given year and ends on September 30 of the following year.

¹⁹ Revisions to this transition plan would be needed if the draft amendments were not approved by the SEC and effective prior to the MSRB's nomination and election of new Board members who will begin their terms on October 1, 2016.

²⁰ See note 5 *supra*.

²¹ See notes 2 and 4 *supra*.

Alternatives

The MSRB identified and considered the following as the main alternatives to the approach proposed in the draft amendments.

The MSRB could propose to extend terms to more than four years and/or ease the conditions under which Board members may serve consecutive terms. While each of these approaches would similarly address the continuity and institutional knowledge concerns, the MSRB believes that more regular turnover of a significant number of Board members also has benefits. At the current juncture, the MSRB is therefore proposing the more limited term extension of a single year.

The MSRB also could couple the term extension with new limitations such as a lifetime cap on the number of years a Board member could serve. The MSRB believes that such a limitation would unnecessarily limit its flexibility to elect the best candidates to the Board and to address special circumstances that may arise.

Additionally, the MSRB could elect not to propose changes to Rule A-3 and devote additional resources, beyond the significant resources already allocated, to educating new Board members. This approach, however, might not address adequately the interest in improving Board continuity and institutional knowledge during complex rulemaking initiatives that more and more frequently exceed three-year periods.

Finally, rather than achieving four-year terms by electing four classes over four years (three classes comprised of five members and one class comprised of six members), the MSRB could maintain the current approach of electing only three classes, each comprised of seven members. This alternative would follow the MSRB's current approach to the composition of each Board class, but would necessarily mean that the MSRB would not elect any new members once every four years.²²

²² As specifically provided for in the MSRB's Policy on the Use of Economic Analysis in Rulemaking, the Board has excepted this rulemaking initiative from the particular terms of that policy. While the primary purpose of the policy is to avoid unnecessary regulatory burdens in the municipal securities market, the draft amendments involve only administrative changes and will not place any regulatory burden on market participants. The MSRB nevertheless has, as discussed above, identified the need for the draft amendments and the main alternative approaches. Additionally, the Board considered whether the rule would affect efficiency, competition, or capital formation.

Request for Comment

The MSRB seeks public comment on the following questions, as well as on any other topic raised in this request. The MSRB particularly welcomes statistical, empirical and other data from commenters that may support their views and/or support or refute the views, assumptions or issues raised in this request for comment.

- 1) Would the draft amendments likely provide for greater continuity and institutional knowledge on the Board as a whole?
- 2) Would the draft amendments impose any costs or burdens, direct, indirect, or inadvertent, on investors, municipal entities, obligated persons or regulated entities? Are there data or other evidence, including studies or research, that support commenters' cost or burden estimates?

October 5, 2015

* * * * *

Text of Draft Amendments²³

Rule A-3: Membership on the Board

(a) No change.

(b) *Nomination and Election of Members.*

(i) Members shall be nominated and elected in accordance with the procedures specified by this rule. The 21 member Board shall be divided into ~~three~~four classes, ~~each~~one class being comprised of ~~seven~~six members ~~and three classes being comprised of five members~~, who serve ~~three~~ four-year terms. The classes shall be as evenly divided in number as possible between public representatives and regulated representatives, ~~and there shall be at least one municipal advisor representative per class that is not associated with a broker, dealer or municipal securities dealer.~~ The terms will be staggered and, each year, one class shall be nominated and elected to the Board of Directors. The terms of office of all members of the Board shall commence on October 1 of the year in which elected and shall terminate on September 30 of the year in which their terms expire. A member may not serve consecutive terms, unless special circumstances warrant that the member be nominated for a successive term or because the member served only a partial term as a result of filling a vacancy pursuant to section (d) of this rule. No broker-dealer representative,

²³ Underlining indicates new language; strikethrough denotes deletions.

bank representative, or municipal advisor representative may be succeeded in office by any person associated with the broker, dealer, municipal securities dealer, or municipal advisor with which such member was associated at the expiration of such member's term except in the case of a Board member who succeeds himself or herself in office.

(ii)-(vii) No change.

(c)-(g) No change.

(h) *Transitional Provision for the Board's Fiscal Years 2013~~7~~, 2018 and 2014~~9~~.*

(i) Notwithstanding any other provision of this rule, for the Board's fiscal years commencing October 1, 2012~~6~~ and ending September 30, 2014~~9~~, the Board shall transition to ~~three~~four staggered ~~classes, one class of six and three classes of seven~~five Board members ~~per class~~. During this transitional period, Board members who were elected prior to ~~July 2011~~ and whose terms end on or after ~~the Board's fiscal year 2016, September 30, 2012~~ may be considered for term extensions not exceeding ~~two~~one years, in order to facilitate the transition to ~~three~~four staggered ~~classes of seven Board members per class~~. Board members shall be nominated for term extensions by a Special Nominating Committee only comprised of members not being considered for extensions~~formed pursuant Rule A-6~~. The Board shall vote on each nominee for term extension prior to the end of fiscal year 2014~~6~~.