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Transcript: Compliance Outreach Program for Municipal Advisors

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This transcript has not been edited for content.

Drew Bowden: Everybody's so attentive. Ma'am? Okay. I'm getting the high sign to start up here for those of you tucked behind the podium. And welcome, everybody, the first Municipal Advisor Compliance Outreach Program. This is a collaborative event that's sponsored by the Municipal Securities Rulemaking Board, FINRA, and the SEC. Joining me up here today are Larry Sandor from the MSRB and Ed Wegener from FINRA, and I'm Drew Bowden. I'm the Director of the Office of Compliance, Inspections, and Examinations at the SEC.

For starters, I'd like to thank our hosts at the Federal Reserve Bank of Chicago for allowing us to use this fantastic space, as well as, I think, on behalf of Larry and Ed and myself, thanking our teams who have gone to such great lengths and effort to put this event together today.

I'm going to take a couple minutes just to maybe introduce O.C. and the SEC to you, and give a high-level overview of the ground that will be covered today, and then I'm going to turn it over to Ed to sort of give you the FINRA perspective. Before I do that, as, if you are familiar with the SEC, you'll know, and if you're not, you'll become accustomed to the fact that one of the first things we always have to do is give our standard SEC disclaimer, which I'm doing today on behalf of myself and all of my other colleagues who you'll hear from. And that is that the SEC disclaims responsibility for any statement or private publication made by any of its employees, including me, and so the views expressed here today are those of each speaker, and do not necessarily reflect the views of the commission, the commissioners, or any other member of the staff.

With that said, as I said, I'm pleased to be able to be here with you to introduce the Securities and Exchange Commission, and I had mentioned there's really two offices within the Securities and Exchange Division that you're going to hear from today. One are our colleagues in the Office of Municipal Securities, and the other are individuals from OCIE, or the Office of Compliance, Inspections, and Examinations. As I mentioned, I'm the Director of OCIE, and our mission is really fourfold. We exist to do exams to promote compliance, prevent fraud, identify risk, and inform policy. Our OCIE staff consists of about 900 examiners who conduct exams from 12 offices around the country. Our home office is in Washington, D.C., and we have offices in pretty much every major city in the U.S. I won't go through them all, but obviously, including Chicago. Our office here is right across the street.

We conduct examinations of many different types of financial firms. Investment advisors, broker-dealers, mutual funds, stock exchanges, SROs, clearing agencies, transfer agents,

and of course, now pursuant to new rule making under Dodd-Frank, municipal advisors. In our exams in OCIE, we really go out into the field as the eyes and ears of the commission to conduct exams to see whether or not firms are operating in a manner consistent with the federal securities laws. I know many people who are registered as admissible advisors are also registered as broker-dealers, and may have been examined or I aced [spelled phonetically] and they may have some familiarity. I think there's some percentage of the people in the room who probably have not yet been examined, whether it's by FINRA, or by the SEC. For us at the SEC, when we do an examination, in most instances, about 85 percent of the time, we issue what we call a deficiency letter to the firm, and we ask them to respond in writing and let us know what they're going to do to address the deficiencies that we've identified. In a smaller percentage of instances, usually a little over 10 percent of the time, we will also make a referral to our colleagues at the SEC in the Division of Enforcement.

But in addition to doing exams and working directly with registrants, I mentioned that the first pillar of our mission is to promote compliance. We like to say in OCIE that we recognize and understand as we go out into the world that most of the people we deal with are good people trying to do the right thing. They're trying to help their clients, they're trying to grow their business, they're trying to provide for their employees. But they're doing it in an environment that's competitive, complicated, and rapidly changing. So we don't play a game of gotcha on exams. We try to be as transparent as we can be about what we're doing, and in furtherance of our efforts to promote compliance, we do a whole bunch of stuff. So we publish risk alerts, we publish letters like I hope most of you, if not all of you, in this room received a letter we sent out sort of introducing ourselves to the newly registered municipal securities advisors, and letting you know what to expect in exams.

And we also do outreach events around the country, like this one. Our staff will appear at events like this to talk about our program, share the podium with other regulators, and make sure that really, there should be no surprises when our exam team shows up. Our team has put a lot of effort into today's outreach event, as I mentioned, because many of you may not have been examined, and we wanted to make sure you know what to expect. Our program is designed to reach as many of you as we possibly can, either here in person, or we're also being webcast today, so there are people tuned in from all around the country.

Some of the things we're going to cover today. First, we'll be discussing what new rules and regulations from the MSRB are in effect and require compliance, as well as new rule proposals by the MSRB that may -- or will require your compliance if and when they become effective. That panel's going to discuss new obligations specifically related to registration, fiduciary duty, standard of conduct, supervisory responsibilities, and books and records obligations. Another panel is going to talk specifically about what it means with the fiduciary standard of care, another standard of conduct mean, and how they're relevant to your practices, and third, we'll cover what to expect during both an SEC and a FINRA exam.

I think on behalf of all of us up here, we would encourage everybody throughout the day to ask questions. This is intended to be an engagement with the industry. I know our team, I think, has pads, so if people have a question, they can raise their hand, and we'll collect those from you. As I said, on behalf of all of our colleagues at the commission, we really appreciate you talking the time to be here today. We hope it's a beneficial use of your time.

And with that, I'm going to turn the podium over to Ed Wegener. Ed is the vice president and Midwest Regional Director of FINRA. He's responsible for the regulatory programs in FINRA's Chicago and Kansas City district offices. Ed's been with FINRA since 1998, and before that, Ed was out in the industry. So Ed, turning to you.

Ed Wegener: Well, thanks, Drew, and I really appreciate it. I thought what I would do today is to talk about FINRA, its role generally, its role specific to what it is we do in the municipal security space, and also now, with the municipal advisors, and then let you know what you can expect from -- for those who are FINRA members, what you can expect from a FINRA examination. But before I do, I really just want to say that we really do appreciate the opportunity to be here today, to engage in this dialogue with, you know, our co-regulators in this space, and also to echo Drew's thanks to both our staff, and to the Fed for allowing us to be here, and the work that they put into making today's event a success.

FINRA's role is a unique one. As a self-regulatory organization, we're responsible for regulating the securities activity of registered broker-dealer firms, and there are just over 4,000 registered FINRA members for whom we're responsible regulating, writing rules, conducting examinations, enforcing those rules for our members. But this includes, also, specifically examining and enforcing the rules of the SEC and the MSRB when it comes to municipal securities activity of our member firms. And for those FINRA member firms that are also registered as municipal advisors, we have been designated with the responsibility to examine for, and to enforce the municipal advisor rules that we're going to be talking about today.

But importantly, one of the things that we're also going to be doing as we conduct examinations of our member firms, especially those member firms that aren't registered as municipal advisors, taking a look at the activity that they are conducting, and ensuring that, if they're conducting, the types of activities that would require them to be registered as municipal advisors, to make sure that they do so. So both of those things are going to be important factor things that we'll be conducting in our examination program as we go forward.

We have a risk-based examination program, and those of you who are FINRA members have probably heard quite a bit about our evolution from very rules-based examination program to a much more risk-based program. And for those of you who aren't FINRA members, what that really means is that the driver of what we do in our examination program is to understand and really get to identify and assess the risk at specific member firms, and then to use that risk assessment to drive not only the frequency of the examinations that we conduct, but also the scope of the things that we're going to review. So because our examination program is risk based, and we do this assessment on a firm by firm basis, the frequency with which we go out and conduct an exam may vary, as well as when we do go out and conduct an exam, the areas that we focus on will vary. But one of the key drivers for assessing what areas we review are new rules and important rules that have come out to make sure that firms are ready to comply with those rules, and to make sure that, you know, going forward, firms are complying with those rules. So you can anticipate that as we conduct our examination program in 2015 and going forward that we will be focusing on municipal advisory rules, and the activities of municipal advisors.

One of the things that we've been doing over the summer is to train our examination staff on the activities of municipal advisors so that they really understand from an industry perspective what role municipal advisors play, so that when they go out and conduct the exam, they can put the rules and the things that they're reviewing into context. And we've also been training them on the specific rules, the things that you're going to hear about today, so that when they come out and conduct examinations at your firm, they really have a good understanding of your firm, the activity that you're engaged in, as well as the rules that you're required to comply with.

In addition to that, we've spent a tremendous amount of time developing examination guidance and procedures that they'll use to help drive their examinations. We work really closely with both the SEC and with the MSRB, at really understanding the issues that we -- that drive our examination program, and as we develop our examination priorities for any given year. So it's a great effort that we have to work together to really make sure that we're being consistent in how we apply the rules, and how we examine for the rules. So I think that today's event is a great start to that. The opportunity that we have to come to talk to you together not only drives consistency, but it also gives us the opportunity to talk to you about what our expectations are of you as we regulate this space, and then for you to understand what you can expect when we come out and conduct an examination.

But I think that what's as important, if not more important, is for us to hear from you. So I was great to hear that this is going to be a dialogue, because it's important for us not only to hear your questions, to hear where your challenges are, but to get your feedback. And hopefully, this is just the beginning of a regular and ongoing dialogue that we can be part of. But we really appreciate the opportunity to be here today to participate on the different panels that will be going on today, and also to be part of that ongoing dialogue. So, with that, I'll turn it over to Larry.

Larry Sandor: Thank you, Ed. Good morning, and welcome on behalf of the MSRB. I would like to also extend our thanks to the Federal Reserve for this beautiful space, and our thanks to the SEC and to FINRA. I think this is an example of the very good coordination between the MSRB, FINRA, and the SEC. We have continued discussions about the regulation of municipal advisors, but this is a prime example of how we coordinate our efforts.

I see a lot of familiar faces out there, and I did want to acknowledge Steve Apfelbacher, who I see is here today. He is a board member of the MSRB, and he's also a former member of our Professional Qualifications Advisory Committee. So welcome, Steve. Also, Bob Lamb, who is a former board member, is here today, and I'd like to acknowledge his service on the MSRB Board. My name is Larry Sandor. I'm the deputy general counsel of the MSRB. I'm joined here today by two of my colleagues that you're going to hear in a moment, Mike Post and Ben Tecmire, and I want to thank you for participating in this event and also encourage, as Ed did, to be active and ask questions.

As the regulatory environment continues to evolve, the MSRB recognizes the need to engage the municipal advisor community in ongoing dialogue, and we're committed to providing education about each phase of the regulatory process, from the rule proposal to compliance with final rules. Clarity in our rule making, and your understanding of the rules, is essential.

Those of you who are joining us in person should have received flash drives which are preloaded with some useful educational resources. We want to highlight there's a publication on participating in the rule making process, which provides information on the many ways in which municipal advisors can share their input on developing rules. You're also getting an advance preview of the MSRB's first podcast for municipal advisors. This 10 minute audio recording provides a general overview of what it means to be regulated. Those watching the live webcast can access these resources on the MSRB's website at MSRB.org, in the "Resources for Municipal Advisors" area. The podcast, by the way, will be available online tomorrow.

We have a great program today, but before we begin, I want to address a topic that I know is of interest to all of you, which is the development of the professional qualifications exam.

First, let me thank you for your participation in our municipal advisor survey over the summer. We received more than 500 responses to our questions about municipal advisor business activities, and the survey has proven helpful in helping us refine the draft content outline for the municipal advisor representative qualification exam. Given the significant changes that accompany any new regulatory regime, the MSRB believes it important for all municipal advisor representatives, regardless of their years of experience or other certifications, to take the examination. In the near future, we will be filing amendments to our rule G3 with the SEC, which will establish two professional qualification classifications. A municipal advisor representative classification, and a municipal advisor principal classification. Individuals at each of those classifications will be required to take it and pass the municipal advisor representative qualification examination under the proposal.

The MSRB's PQAC committee, or Professional Qualifications Advisory Committee, is in its last stages of developing their content outline for the examination. Once approved by our board of directors, it will be filed with the SEC, and shortly thereafter in 2015, next year, the MSRB will release a pilot examination, which will help us establish the passing grade for the test. If you're interested in volunteering to take the pilot exam, please email us at Pqmailbox@msrb.org. Again, that's Pqmailbox@msrb.org if you're interested in volunteering to take the test.

Let me also, as Ed did, stress that we really do want your engagement, and I'm going to give you my direct email. Feel free to email me if you have any questions. It's Lsandor, L-S-A-N-D-O-R, at MRSB.org. I look forward to your questions and comments throughout the day. Thank you.

[applause]

Michael Post: Good morning. I'm Michael Post, Deputy General Counsel at the MSRB, and while Larry primarily focuses on many things that are relevant to today, coordinating with FINRA and the SEC, supporting those organizations in their examination function and enforcement function, I primarily focus on the rule making at the MSRB.

I will be moderating this session, which is focusing on registration of municipal advisors with the SEC and MSRB, and I'm joined by John Cross, the Director of the Office of Municipal Securities at the SEC, and Jessica Kane, the Deputy Director of that office, and these two have -- who've been the leaders of the office during the period when the SEC was developing its adopting release of its final definition of municipal advisor, and its final registration rules. They've been the leaders of the office during the development of FAQs following the adoption of that final definition, and have overseen the implementation of the registration process at the SEC through the phased-in compliance period from July through, I guess, October 31st. So I'm not sure there's any more phasing in going on. But we will learn this morning.

By, a show of hands-- I'm interested--how many of you are with firms that are already registered with the SEC permanently? And the MSRB? And is anyone as of yet considering whether they are a municipal advisor and will register with the SEC and MSRB? Because this is very helpful to kind of guide the discussion this morning, in addition to what we have prepared. We encourage your questions. Really, your questions will be the best means to guide what you hear today to ensure that it's relevant to you.

The SEC's municipal advisor definition is important not just for determining whether you register in the first instance, but it's critical to determining, even if you are a registered municipal advisor, to whom you are a municipal advisor, and whether the sort of follow on

obligations of a municipal advisor are triggered in your dealings with a particular recipient of potential advice, and the triggering of the MSRB rules that are in development -- that some have been approved by the SEC and will be in effect soon, and others that are in other stages of the rule making process, but in broad measure, you can anticipate going into effect in the coming months and years.

So what I will do is largely turn over the floor to John and Jessica to give some background on the final registration rules. I expect that they'll go into some detail about some of the more prominent exemptions from the registration requirement, like the underwriter exemption, and the independent registered municipal advisor exemption, often known as, to John's chagrin, the IRMA exemption. And we'll take your questions, and at the end, because of the kind of composition of the audience, I'll spend a little time mainly talking about the ongoing obligations under the MSRB's rules for municipal advisors in terms of updating registration information, annually affirming it, and staying current with the required fees to support your self-regulatory organization, which has municipal advisor representatives on the board. So with that, I'll turn it over to you, John and Jessica. Give your remarks.

John Cross: Okay. Thank you very much, Mike. Let me just take a second to comment on my two colleagues, here. Mike Post is a superb lawyer at the MSRB. With him, we've been working very closely on the municipal advisory implementation rules, as well as other MSRB initiatives, and we really value the relationship with the MSRB, and their whole team, and our Office of Municipal Securities, which is a new office created at the SEC under Dodd-Frank act, has assumed primary responsibility for overseeing the MSRB rules, and for working on Municipal securities issues at the SEC. And to my left is our superb deputy director of our office, Jessica Kane, who has been an integral anchor to all the efforts on our final municipal advisor rules, and all the efforts on all the initiatives in municipal securities that we have ongoing.

I'd like to take a few minutes to just ease you all into, you know, municipal advisor compliance rules by giving you a little background on the statute, where it came from, and the final municipal advisor rules, and just to put all this in perspective, let me observe. You know, there are harder things that people have to do in the world than register as municipal advisors, and I was reminded of that last night upon hearing and seeing the guy who wasn't content to walk on a tightrope across a river from the top of buildings in Chicago without a net. He felt compelled to be blindfolded as well.

[laughter]

And so, you know, keep the challenges in perspective. With that, in 2008, concerns arose in the financial crisis about unregulated financial advisors to municipalities. At that time, the MSRB, in April, 2009, did a study on unregulated advisors. Issues included advisors who are -- questions about qualifications, concerns about conflicts of interest, pay to play, and one particular item was issues on complex municipal derivatives in which municipalities often suffered significant losses on derivatives, where there were questions about the suitability, or whether or not they fully understood those derivatives. Example one, Jefferson County, Alabama's bankruptcy. In response to this in the Dodd-Frank act, Congress added a very broad new requirement that municipal advisors register with the SEC, effective October 1, 2010. So temporary registration rules went into effect at that time. The -- this provision aims fundamentally to enhance protections to municipal entities, and imposes a new fiduciary duty on municipal advisors to act in the best interests of their municipal entity clients. This provision also aims to enhance qualification, supervision, and oversight of these municipal advisors, and gives the MSRB a big role in those efforts.

In our humble little Office of Municipal Securities, we spent our first year of operations. We're working on the slim and trim 777 page final municipal advisor registration rules, which the commission adopted unanimously. On September 20, 2013, these final rules went into effect on July 1 of this year. A transition period for the registration process under the final rules began on July 1 of this year, and generally ended on October 31st, although we're still in the throes of getting people registered under the final rules. We also issued two big batches of interpretive guidance on municipal advisor registration rules in the form of FAQs, frequently asked questions, in January and in May of this year, and I commend those to your reading pleasure for lots of helpful interpretive gloss on various issues that market participants raised in this area.

Let's step back to the fundamental framework. A statutory municipal advisor definition is -- a municipal advisor is defined broadly to mean a person who provides advice to or on behalf of a municipal entity, or an obligated person. That's a fancy word for, basically, conduit borrowers and municipal financings with respect to several things. Municipal financial products, including municipal derivatives, guaranteed investment contracts, and investment strategies, or, most fundamentally, the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues, and also, a separate prong of the whole thing involves certain solicitations of municipal entities. We're going to focus mainly on the core municipal advice aspects, however, here.

Absent an available statutory or regulatory exemption, a municipal advisor must register with the SEC in the subject of training, qualifications, and record keeping requirements. They also must register with the MSRB. So, let's take a minute just to lay the groundwork on, you know, what are we regulating, here? What is advice? What is the advice standard? The advice standard under the final rules, first, is the facts and circumstances standard. Most importantly, on the positive end of what is advice, advice includes certain recommendations that are particular to the specific needs, objectives, or circumstances of a municipality. Conversely, advice does not include general information that does not involve recommendations. Examples -- in other words, all communications are not advice that put you into this regime. Examples of general information include information that's factual without subjective assumptions, opinions, or views, information that's not particularized to a specific municipal entity or type of municipal entity, information in the nature of educational materials, or information that's widely disseminated widely for use by the public. Our FAQs flesh out the general information standard and the advice standard a great deal, and basically, the first FAQ we did.

This regime covers advice, not on everything, but on three topics. First, the issuance of municipal securities, including structure, time and terms, and other similar matters. We interpreted this broadly time-wise to include advice from the early planning stages of a municipal bond issue, to bond redemption. Second, advice covers advice on investments. Not investments of everything, but investments of bond proceeds, proceeds of municipal securities, and the recommendation and brokerage of municipal escrow investment. Basically, bond proceeds in refundings. This is under the investment strategies definition. And finally, advice includes advice on municipal derivatives. Two types. Basic swaps, which are largely regulated by the CFTC, and security base swaps, which are regulated by the SEC.

Let me now take a minute to turn to the exemptions. The structure of this statute is such that it has a really broad general coverage, and then everyone in sight who didn't want to be under the statute saw an exemption, so there's a whole list of exemptions. And we tried

very carefully in both statutory exemptions, and in regulatory exemptions, to focus thematically on identified activities on market participants that warranted exceptions or exemptions as opposed to the status of market participants. In other words, you don't get out of this regime just because you're a broker-dealer. We also sought to take carefully into account avoidance of duplication of regulations, so that, for example, several of the exemptions are just tied directly to other regulatory regimes. Let me just take a minute to go down the list of exemptions, and then after that, I will turn it over to Jessica Cain to go into some more juicy detail on a couple of those exemptions.

There's -- two thirds of the comment letters in the public comment process for these rules involved whether or not individuals who are basically employees or board members of municipal entities, if they gave advice to their municipal entity, would that be covered under these rules, whether they're elected board members, or appointed board members, or members of committees. I think we've got 600 and, you know, 75 letters on that topic alone. We addressed that topic. We have a broad exemption that covers public officials, both elected and appointed, and public employees, that provide advice basically under a standard of acting within the scope of their official capacities.

Next exemption, the underwriting exemption. A statutory exemption covers registered broker-dealers and municipal securities dealers serving as underwriters within the meaning of the Securities Act of 1933, and we interpreted that carefully to cover an underwriter's advice regarding a particular transaction. It is transaction oriented, and this -- and once you're in the capacity of an underwriter, though, it broadly covers advice under structured timing turns, and other matters, with respect to these transactions. Importantly, the underwriting exemption does not cover advice on investments. That is not -- essentially, that's not an activity that's within the scope of that function, and it also does not cover advice on municipal derivatives, which is really an area in which the waterfront has been covered by other regulatory sectors.

Jessica's going to discuss the parameters in the underwriting exemption further. You know, we thought it was important that it be very clear when you get -- when that exemption starts, and when it ends, and how you get into it, because particularly with small issuers in the financial crisis, a real issue was ambiguity on the roles of broker-dealers with less sophisticated issuers.

Another exemption that's very relevant is -- and I'll concede the acronym, the IRMA exemption. Independent Registered Municipal Advisors. This important exemption permits the free flow of information between market participants and municipalities in the case where the municipality is represented by an independent registered municipal advisor. This exemption has certain procedural conditions which will be -- we will discuss further. The key idea, though, is that if you've got an independent advisor standing at your side, it should be okay to get advice from other folks in a transaction.

Next, let me just rattle off a whole bunch of other exemptions real quick. There's an exception for SEC-registered investment advisors that provide investment advice, as contrasted with advice on structuring bond issues, or advice on structuring municipal derivatives that are used in bond issues. We clarified in an FAQ that certain municipal derivatives that are part of advice on investment portfolio registered investment advisors historically have done are covered within that exemption. Another exemption is for registered commodity trading advisors. This is basically swap advisors with the CFTC. A tailored -- another exemption is a tailored exemption for banks, cover certain identified traditional banking activities, deposits, extensions of credit, loans, direct purchases of municipal securities for a bank's own account, but not other things. There's an exemption

for attorneys that covers legal advice and traditional legal services, but not attorneys that hold themselves out as financial advisors, or financial experts.

There's an exemption for accountants that covers accountant supervised audit or test services, prepared financial statements, or issue letters for underwriters. One of my personal favorites is the next one, the exemption for engineers that covers engineering advice. We had way too many meetings with engineers expressing angst about these rules. We're not really looking for engineers, here. Finally, there's an exemption for requests for proposals, or requests for qualifications. Basically, circumstances in which an issuer has within its control, you know, sat down, sort of defined parameters of seeking advice from certain market participants on certain activities or things they need, with the issuer's control being important. We felt that's a way that you could -- there could be an exemption from this regime. In our FAQs, we try to flesh that out a lot about how that works, and how it's not necessarily the full-blown formal statutory process at various state levels, but could be more formal -- more informal in the way it operates as long as it's sort of under the direction of the municipal issuer.

And with that, I will stop and turn it over to Jessica Cain to talk about a couple of these exemptions in further detail, and then to give you some insight into her heroic efforts on trying to get the registration process for the final rules implemented.

Jessica Kane: Thank you, John. As John mentioned, the underwriter exemption covers registered broker-dealers and registered municipal securities dealers serving as underwriters, with respect to an underwriter's advice regarding a particular transaction for the issuance of municipal securities, including advice on the structure, timing, terms, and other similar matters. The underwriter exemption does not cover advice on the investment of bond proceeds, or advice on municipal derivatives. As John mentioned, the FAQs flesh out some important details relating to advice, including interpretive guidance on the extent to which broker-dealers can provide business promotional materials under the general information exception to advice. The time period for application of the underwriter exemption begins at the time of engagement of an underwriter on a particular transaction, and extends until the end of the underwriting period.

FAQ 5.1 clarifies that an issuer's engagement of an underwriter may be on a preliminary basis subject to certain conditions, such as approval by the issuer's governing body. FAQ 5.1 emphasizes that an important basic component of the underwriter exemption involves the affirmative decision by the municipal entity, or the obligated person, to select the broker-dealer to serve as underwriter on a particular issuance of municipal securities, and that affirmative decision is fully informed by the disclosure of the role of underwriter as required by MSRB rule G17. FAQ 5.1 also notes that a broker-dealer's unilateral action to identify itself in writing as an underwriter, and not as a financial advisor under MSRB rule G23 is insufficient to establish that the broker-dealer meets the underwriter exemption.

Moving on to the IRMA exemption, this is an important new exemption that covers advice given when a municipal entity or obligated person is represented by an independent, SEC registered municipal advisor. When the conditions of this exemption are met, the exemption should foster the free flow of information between market participants and municipal entities because the IRMA is positioned to help its municipal entity or obligated person client evaluate the advice received from other market participants, and identify any conflicts of interest. To qualify for this exemption, first, the market participant must receive a written representation from the municipality that the municipality is represented by and will rely on the advice of its IRMA. The FAQs clarify that this "rely on" language means that the municipality must seek and consider the advice, analysis, and perspective of its IRMA, but

not that the municipality is required to follow such advice. A municipality may post this type of representation on its official website, and the market participant must have a reasonable basis for relying on the representation.

Second, the municipality must receive a written disclosure from the market participant that the market participant relying on the exemption is not a municipal advisor, and is not subject to any fiduciary duty. Slightly different representation in the case of an obligated person, which omits the fiduciary duty reference. And third, the IRMA must be engaged to provide advice with respect to the same aspects of the municipal financial product or issuance of municipal securities as the market participant relying on the exemption.

The independence test looks at certain entity level and individual level associations between the registered municipal advisor and the market participants for a two year period. The individual level analysis focuses in part on participation of certain individuals in municipal entity activities. The IRMA exemption only covers advice within the scope of the engagement of the IRMA. For example, an advisor advising on structuring an issuance of municipal securities, or an advisor on investments of municipal bond proceeds, or municipal derivatives.

One cautionary point. The IRMA exemption requires a meaningful engagement of the IRMA in a way that the advisor is advising the municipal entity or obligated person in a substantive way to give effect to the policy underlying this exemption. That the free flow of advice from unregistered municipal market participants is justified when protected by the safeguard of an IRMA clearly standing on the side of the municipal entity to look out for the municipal entity's best interest, and vet potential conflicts.

The final municipal advisor rules, however, do not mandate the use of the IRMA exemption. Thus, for example, if a municipal entity seeks to rely on advice from its underwriter about structuring a transaction for the issuance of municipal securities, the municipal entity may engage an underwriter for that purpose subject to the parameters of the underwriter exemption.

Moving on the registration. The SEC's final registration process is now in effect. The SEC's final municipal advisor rules went into effect on July 1, 2014. Municipal advisors were required to register with the SEC through the SEC's EDGAR system using the final registration form on a staggered basis over a phase in compliance period, which began on July 1, 2014, and ended on Friday, October 31st. Therefore, all municipal advisors that previously registered with the SEC on form MA-T, and expect to continue to be a municipal advisor, should have already submitted a form MA and all required form MA-Is to the SEC through EDGAR during this phase in compliance period. Furthermore, in general, any municipal advisor that now seeks to register with the SEC as a municipal advisor must use the final registration process. The temporary process on form MA-T is no longer in effect. All existing temporary registrations on form MA-T either have already expired, or will expire by December 31st, 2014.

So who is required to register as a municipal advisor with the SEC? Municipal advisory firms are required to register with the SEC through EDGAR on form MA. While individuals are not required to register with the SEC, municipal advisory firms are required to submit a form MA-I for each individual associated with the firm who engages in municipal advisory activities on the firm's behalf. Unfortunately, putting these requirements together, that means sole proprietors have to submit both a form MA, and a form MA-I.

So what are you required to do to register with the SEC? First, I'll just briefly list out the

MA form. Form MA, this is the initial application for registration for the municipal advisor firm, and also any amendments. Form MA-I is for the individuals. Form MAW, this is the form used to provide notice of withdrawal from registration as a municipal advisor. This can only be used after the SEC has granted your municipal advisor registration on form MA. This cannot be used to withdraw a temporary registration on form MA-T. And finally, form MANR. This is the form used by municipal advisors that are not U.S. residents to designate a U.S. agent for service of process. The general instructions glossary and adopting release also provide additional guidance with respect to the form, so I encourage you to take a look at the general instructions glossary and adopting release for further information.

So, to register with the SEC as a municipal advisor, first, you must obtain access to the EDGAR system. Second, you must submit a complete form MA for the municipal advisory firm, and a complete form MA-I for each individual engaged in municipal advisory activities. A few tips on this process: you must submit both MA and MA-I through the EDGAR system. I encourage you to submit these forms as close in time as possible. While the commission has 45 days to review a municipal advisor's registration, that 45-day review period does not begin until the commission receives a complete form MA, and all other required documents, including all required form MA-Is.

Review your form MA and MA-Is for completeness, and save these files before submitting them to the SEC through EDGAR. An incomplete form MA generally will be suspended during the SEC's review process. If your form MA is suspended by the SEC, you will be required to add the missing information to the form MA, and resubmit the form through EDGAR. If you've saved your files, this process can be a lot easier. You should be able to upload the previously saved file and change the missing information. Also, if your form MA is suspended, it was not considered complete, and the 45 day review period will start when you resubmit your form MA, assuming it is complete.

A brief word on attachments and exhibits. There is no process in place for the commission to remove personally identifiable information if they are submitted in these attachments or exhibits. While the EDGAR system will block social security numbers, birth dates, and other personally identifiable information from being included in the publicly available forms of form MA and form MA-I, it will do so only in those sections where the SEC has specifically required this information, and provides guidance that such information will not be included in the publicly available forms. I would encourage you to take a look at any attachments or exhibits to your form MA, or for MA-I, and think about whether they contain PII. If you have any questions, you should feel free to call the Office of Municipal Securities. We're happy to discuss this process and this issue.

With respect to amendments, you can only amend a form MA or MA-I after the commission grants your initial application for municipal advisor registration. You may not amend a form MA or MA-I while that form is under review by the SEC. A municipal advisor is required to file an annual update of its form MA within 90 -- 90 days.

[laughter]

That'd be quite an update.

Drew Bowden: On the fast track.

[laughter]

Jessica Kane: Within 90 days after the end of its fiscal year, and for full proprietors, it's the

calendar year. In addition to the annual update, a municipal advisor must promptly file an amendment to its form MA whenever a material event has occurred that changes the information provided in the form. The instructions for the form MA series provide further guidance on when a material event will be deemed to have occurred. A form MA-I must be amended whenever the information previously included becomes inaccurate. And finally, a little good news. The SEC does not charge any fees in connection with municipal advisor registration. So there's no fee to submit the form, and there's no fee to become an SEC registered municipal advisor.

When are you required to register with the SEC? As I previously mentioned, the phased in compliance period for SEC municipal advisor registration ended on October 30th -- 31st, 2014. Therefore, all municipal advisors that previously registered with the SEC, and that expect to continue to be a municipal advisor, should have already submitted a form MA, and all required form MA-Is. All new entrants to the municipal advisory business must first register with the SEC as a municipal advisor under the final municipal advisor rules.

How does the registration process work at the SEC? Assuming you have successfully transmitted your form MA and form MA-I, there will be a popup window that indicates your submission was transmitted successfully, and it will provide you an accession number for the filing. You may use this accession number to track the status of your application in the EDGAR system. As I mentioned, the 45 day review period does not begin until the municipal advisor has submitted a complete form MA, and all required form MA-Is.

An easy way to check to see whether you've submitted all of your form MA-Is is to compare the number of MA-Is you submitted to item 4B of form MA, which is the number of employees engaged in municipal advisory activities. After the commission receives a complete form MA, and all the required form MA-Is, the commission has 45 days to grant municipal advisor registration, or institute proceedings to determine whether to deny. If the commission determines to grant your municipal advisor registration, you'll receive an EDGAR-generated email notifying you that your submission has been accepted. This means the SEC has granted your registration. This email will include the filing date and the filing number. It's an 867 number for your form MA, and an 868 number for MA-I, and this number will be important in MSRB registration, which, I think, Mike will talk about later.

After the commission grants your registration, it will be published on the SEC.gov EDGAR website. This is a public website, and you may direct clients or others to this website to review your form MA and MA-Is, and as evidence of your registration status with the SEC. You will also receive a paper order via US. Mail. If the commission does not grant your municipal registration, the commission will institute proceedings to determine whether to deny your municipal advisor registration. Under the Exchange Act, the commission is required to deny a firm's registration if it finds that if the firm were so registered, its registration would be subject to suspension or revocation under the Exchange Act. This is a formal process. The commission would institute proceedings which would provide a notice for the grounds of denial under consideration, and an opportunity for a hearing, and this must be concluded within 120 days of the filing of the municipal advisor application. At the conclusion of such proceedings, the commission is required to either grant or deny such registration by order.

Michael Post: Thank you, John and Jessica. We have some questions, and I have a couple of questions of -- I'll focus on the audience questions first, of course. So, one was asking -- well, pointing out that some major, or at least very frequent issuers are finding the representation and documenting process for the IRMA exemption to be burdensome, and the question is whether the SEC's going to consider any sort of sophisticated issuer

modification to that process to establish the IRMA exemption.

John Cross: I'll kick off that question. I think, you know, initially, we want to give this regime some time to see how it works in practice. It's just barely gone into effect, and, you know, at some level, the most sophisticated issuers are also the issuers best equipped to work within this regime as it currently exists. That is, they're most frequently the ones that have municipal advisors, and most frequently the ones that are able to use the IRMA exemption. You know, we've tried to make that user friendly by allowing people to post representations about it on their websites.

The premise of that exemption is that issuers, you know, sort of control the process. You know, of course, more generally, you know, in other areas, there are various exemptions that sort of tailor for sophisticated investors, for sophisticated frequent well-seasoned issuers, and the corporate contacts that sort of tailor the rules to the more sophisticated end of the spectrum of issuers. And so, you know, we certainly could consider some kind of sophisticated issuer exemption. You know, I think the regime needs to have some time to operate to see how it's working in practice.

I -- you know, there's an -- the -- this is not something -- people have asked in the past. This is not something we can just go do interpretively. This would require, you know, a new commission action to make a policy call in an order other amendment to a rule to address that, and it, of course, would have, you know, some tricky issues about who you define as sophisticated. Is it, you know, how much debt you have outstanding, how frequently you issue, how currently you do your financial statements, or other kinds of considerations. You certainly could address parameters on that. But, you know, everyone who wants an exemption thinks they're sophisticated, and so, you know, it's not always, you know, it's kind of the eye of the beholder. Jessie may want to add to that.

Jessica Kane: The only thing I have to add is as John mentioned, this isn't something we could do interpretively, but if there are things that you all are seeing in the market, and there are things we could do interpretively, if there's something that an additional FAQ, or additional interpretive guidance could help, or if we could do something by highlighting an issue in an FAQ, you know, we'd be happy to hear about that, and happy to consider it. So please feel free to reach out. I know that was mentioned during the welcoming remarks, but please feel free to reach out to anyone in our office to the extent you have questions or suggestions for interpretive guidance based on what you're seeing in the market.

Michael Post: So, we have another question regarding someone who'd filed an MA-T, and doesn't intend to permanently register, and asks is there a requirement for a firm to file the MAW form to withdraw, or is it enough to just let the MAT expire?

Jessica Kane: So the MA-W is a form that is only able to be used once the commission has granted your registration on form MA. MA-T is an entirely different system. To withdraw a form MA-T, you simply file a new form MA-T, and there's a box that you can check to withdraw it. It's a very simple process, and we are encouraging folks who have determined that they're not going to be municipal advisors, and they're not going to register on form MA-T, or submit any Form MA-Is to withdraw on Form MA-T by checking this box and submitting a new Form MA-T. We think that will help complete our records, and it will hopefully help some of our folks in OCIE from making a lot of phone calls, wondering why you didn't register on Form MA.

John Cross: Let me just -- another quick point of context on that. You know, I didn't ask at the beginning of the session. You know. There were the two questions of who's

registered with the SEC under the final rules, and who's registered with the MSRB under their rules for municipal advisors. Who -- the follow-up question was who are the rest of you all --

[laughter]

-- that didn't raise your hand on either one of those questions? But I want to flag an issue, which is -- and it relates to this record keeping issue, which is, you know, around the end of the year, the temporary registration regime for municipal advisors turns into a pumpkin, goes away completely, expires, on December 31st, and, you know, anecdotally, you know, we have some sense that there are a whole lot of people out there who registered under the temporary rules who thought that did the trick, and they don't have to do anything else, and haven't showed up to register under the file rules, or to register on EDGAR. And so part of Jessica's point of, you know, complete the record by withdrawing on the MAT, relates to, I think, an exercise that will occur early next year, which is, you know, in the compliance and exam programs, people will begin to look at, okay, you know, where do we stand on this final registration regime, and has everyone come in who should, and do we need to do more outreach or exams or what to address that? So that's a coming issue.

Michael Post: So while -- some, I think, that might be quick, and then I can go to some that might be more involved, but this one, I suspect, may be something you could quickly clarify. The questioner asks: would you characterize the IRMA exemption as possibly allowing underwriters to discuss more topics than the underwriter exemption alone would allow?

Jessica Cain: Yes. The IRMA --

Michael Post: Elaborate.

[laughter]

Jessica Kane: Sure. The IRMA exemption is really designed to provide and facilitate the free flow of information between market participants and a municipal entity, or an obligated person when the independent SEC registered municipal advisor is standing on the side of the municipal entity or obligated person, owes them either a fiduciary duty or a duty of fair dealing in the case of an obligated person, and is there to help evaluate the advice received by these other market participants, and identify any potential conflicts of interest. You know, we really designed that with that policy rationale in mind, and, you know, the underwriter exemption is very circumscribed and narrowly tailored to underwriting activities within the definition of the 33 acts. So it certainly could be that market participants, including underwriters, would provide more information in the context of an IRMA exemption than any of the other exemptions.

John Cross: And just as a matter of topics, the underwriting exemption covers structuring the bond issue once you've been engaged as the underwriter. It does not cover advice on investments of bond proceeds. IT does not cover advice on municipal derivatives. If you had a registered independent municipal advisor, then the underwriter could also give you sort of supplemental advice on investments and derivatives where you've got the financial advisor also looking at that from the standpoint of having a fiduciary duty to misfiling. Yeah. I mean, it was the case that conflicts with underwriters over derivatives was a real problem in the financial crisis.

Michael Post: Jessica, this questioner understood you to be referring to a slight difference

in the IRMA exemption when dealing with an obligated person versus when dealing with a municipal entity, and they're wondering if you could expound on that.

Jessica Kane: Well, the statute provides that a municipal advisor has the fiduciary duty with respect to its municipal entity clients, and that's not the case with respect to obligated person clients, so the slight tweak that I mentioned has to do with the exchange of representation, and it's the representation that a municipality must receive from -- or an obligated person must receive from the market participant that the market participant is relying on the IRMA exemption, and is not a municipal advisor, and is not a municipal advisor, and is not subject to a fiduciary duty. The fiduciary duty disclosure goes to municipal entities, and the disclosure that goes to obligated persons omits that fiduciary duty reference.

Michael Post: The next question related to the underwriter exemption, and it has to do with, I think, an FAQ that addresses the subject where an underwriter could be sort of preliminarily engaged, and it could be for consideration of a potential issuance, and the engagement could end without ultimately there being any issuance, and I think some of the rationale behind that was that at least the issuer would have taken an affirmative step to reach out to the underwriter, and perhaps understand the underwriter's role by doing that. And the questioner says that they have observed in the market a number of these sort of soft engagements and -- that allow on the underwriter exemption, and they wondered if you had any comment on kind of the prevalence of this practice, or any more kind of expoundment on that FAQ.

Jessica Kane: Well, I think that FAQ talks about, you know, provides the parameters of the underwriter exemption. You know, in the staff's view, and talks about, you know, the interplay between some of the MSRB rules, and the SEC's underwriter exemption under the final municipal advisor registration rules, but I think that FAQ also talks about, you know, the issuer reasonably expects to work with this underwriter in engaging this underwriter in a preliminary engagement letter. I think any effort to, you know, move around that reasonable expectation of engagement is potentially troublesome. I'm not aware of these practices happening, so please call us up and tell us about this when you see this, but to the extent that underwriters and issuers are using the, you know, parameters that we talked about in our FAQs as a way of moving around the municipal advisor rules, you have to find that concerning.

John Cross: Let me just add a point or two about sort of our FAQ that talked about preliminary engagements of underwriters. I think two important features of that, mike, you alluded to them. One was that we want the issuer doing the deciding. So we want the issuer to say to the broker-dealer, "Yes, we want you to be our underwriter." We want that to be an informed, affirmative decision by a municipal issuer. We also want it to be informed by disclosure by the underwriter of the G17 disclosures about the nature of the role of the underwriter. By contrast, one of the things that we were sort of guarding against is we didn't want it to just be automatic under rule -- MSRB rule G-23 that a broker-dealer sends you a letter and says, "I want to be your underwriter. Thus, I'm your underwriter." You know. It's not that existential. We want the issuer sort of in control of deciding.

Within that, we did allow for it to be preliminary. In other words, there was a lot of angst that in underwriting relationships, you know, the issuer doesn't, you know, officially, totally, fully, you know, approve the thing until the pricing, you know, on the day before the closing. Well, we were intending to allow at a much earlier stage in the transaction, you to -- an issuer to say, "Yes, we want you to be our underwriter and hear advice on that," so that it can have conditions of, you know, working out the final terms. But as Jessica cautioned, it,

you know, also does need to be real, and a reasonable expectation on a particular bond issue.

Michael Post: So this next question relates to the independence requirement for the IRMA exemption, and the questioner wondered if you could talk in a little more detail about the independence test for individuals, and the questioner believes that given the movement that frequently occurs in this industry between firms that the two year periods could significantly reduce the number of firms that can take advantage of the IRMA exemption.

John Cross: You want to start, or -- let me make a comment or two about that. I think the most important thing to appreciate about the -- sort of the independence test with individuals was that it is something you can control with participation. That is, if you have an individual who is in the municipal finance business, to take an example, at a broker-dealer, and moves over to a municipal financial advisory firm, the core message of how the independence test works is you need to screen that individual off from participation in, you know, basically client engagements involving that broker-dealer with a particular municipal entity for two years. We've heard a lot of angst about how, "Oh, geez, you know, it's such a challenge," but it really is a matter of focusing on the participation of the potential affected individuals once they're at the municipal advisory firm, or vice versa. It is not a, you know, total bar, but the idea is, you know, there's a potential conflict if, you know, someone was working in this business, in the municipal finance business, at a broker-dealer, who's not working with an issuer. One of their former employees is now working for the municipal advisor. It raises the question of a conflict, there. But with a fix, the fix being don't participate for two years, and screen them off.

Jessica Kane: I will just add that FAQ3.6 goes into painstaking detail of the entity level and individual level tests. So commend that to your reading pleasure, as well.

Michael Post: The next questioner asks if it's correct that an accession number can only be checked, I think, in terms of its status, for a certain number of days, and if so, how can the applicant check on the status of a registration form after that number of days?

Jessica Kane: The accession number should be valid during the time that the commission is reviewing your Form MA. There might be some technical issues that happen if the Form MA is suspended for being incomplete, but the accession number should be available. If you're having trouble with accessing the status of your Form MA by entering the accession number, please, you know, give our office a call, and we'll do what we can to help figure out that situation.

Michael Post: The next question asks whether there are, I guess, any plans or consideration given to further potential enhancements to EDGAR to facilitate some of the functions that are being performed in the market, including diligence by issuers on current or potential MA service providers, and secondly, diligence by market participants in association with the checks that they would do to determine whether an individual is a potential IRMA.

Jessica Kane: So, the commission's EDGAR system is something that is used throughout the SEC. WE are not the only form on the EDGAR system. So any enhancements to the EDGAR system are vetted by a much larger committee, much bigger outside than just the municipal securities office. We certainly could take in any recommendations that folks have as to how to enhance the EDGAR system, but I would say as of right now, there are no current enhancements actively being considered in this area.

John Cross: Let me just add in an informational matter. I think one of the goals once the final registrations are done is that the information about the final registrations get posted on the public SEC website, and so we've gotten some suggestions, I think, to, you know, maybe provide more guidance on how people look out functionally, and search those databases to look for particular firms, or particular individuals or activities related to those firms. So that we do believe that, you know, the EDGAR database of the municipal advisor registrations will be a source that people can look for the kinds of issues you're taught about, Mike, and I think our office will be, you know, receptive to sort of considering ways to guide people on how to do that.

Michael Post: Thank you. We have a few minutes remaining, so I'll try to shift to some of the ongoing obligations. Sir?

Male Speaker: Can you describe the origin of differences between this whole entity, the obligated person, if they seem to be treated differently [unintelligible] Dodd-Frank --

John Cross: I think it's an unfortunate source of complexity. The obligated person -- but it is a source of complexity that's related to the municipal finance business, you know? There, essentially, is -- there are direct municipal financings; general obligation bonds; and bonds of, you know, sort of general purpose municipal issuers where they issue debt for themselves and use the proceeds and go on about their business. There's a whole category of structured financings where there's a loan, a lease, and a solid sale to a conduit borrower who essentially is the beneficiary of the financing, and those conduit borrowers, you know, are integral to a whole category of municipal financings. And the term "obligated person," I think, comes, in part, from SEC rule 15C-212, which has a definition of that in that they have undertakings for continuing disclosure. But basically, in Dodd-Frank, the decision was made that, well, if you have a conduit financing in which a conduit, borrower, or obligated person is involved and the advisors are giving all the advice to that ultimate beneficiary, in substance, you know, that's relevant to the municipality who's serving as a nominal issuer. And so, for that reason, they were included, generally, with a municipal advisor regime.

I acknowledge that -- the fact that they don't have a fiduciary duty and so that there's a bit of -- there's enhanced protection to municipalities, but still bringing them the obligated persons and the regime, it introduces some tricky issues, and we've gotten a lot of questions about that, you know, sort of tried to work through that.

Michael Post: So I tried to raise the questions that seem to be more relevant to a larger number of people. I wasn't able to get to some of the questions that asked about very specific situations, so I'm sure John and Jessica would be happy to answer questions separately or take your calls at their offices, but I just wanted to quickly go through some of the ongoing obligations, administratively, with the MSRB, just so you're aware, and I'll highlight them. So I would encourage you to consult MSRB rules A-11 and A-12 for these and the resources on our website.

The first is to update information on your Form A-12. There is a requirement to keep that information accurate and complete and up to date, an outside requirement to update information within 30 days of a change. Some of the areas where this is particularly important will be for the contacts at your firm listed on the form and the business activities that your firm is engaged in. Form A-12 is also the Form to used to make a change in the information to reflect a withdrawal from registration. And if a firm is a municipal advisor and dealer, then you could select on the Form the remaining registration category of dealer and effectively withdraw as a municipal advisor. If your firm is a municipal advisor only, then you can select withdrawal and leave no ongoing registration

category.

In addition to keeping Form A-12 up to date, the MSRB has an annual affirmation process that happens in about the first half of each January. And in that time, there's a requirement to go into the system and affirm that the information is complete. That affirmation step must be performed by a person that has been listed on the A-12 Form as the primary regulatory contact, optional regulatory contact if there is one, or the compliance contact. For more information about this, you can consult FAQs on our website and the MSRB registration manual, also available on our website.

The other ongoing area is to keep current with fees, as I mentioned, to support the costs of your self-regulatory organization. There is an initial registration fee of \$100, and an annual registration fee of \$500 that's due each October 31st. If your firm is a dealer and municipal advisor, it need only pay one initial registration fee and one \$500 annual registration fee. For municipal advisors, there's also a annual professional fee of \$300 per MA-I submitted to the SEC on the behalf of your firm. So for this year, the first professional fees are due 10 days after the acceptance of your Form MA by the SEC, but after that transition, each year, they will be due at the end of April, based on the number of MA-Is you have on file with the SEC as of January 31st of that same year, and those will be invoiced in early April and due at the end of the month.

So we've gone a little over. I apologize. But thank you for your time and attention. And thank you to my panelists, John Cross and Jessica Kane, for sharing their expertise and answering questions on the SEC registration process.

[applause]

John Cross: Thank you very much.

Drew Bowden: Ladies and gentlemen, we'll have a short break, and panel two will begin at 11:00 a.m.

Ladies and gentlemen, panel two is about to begin.

Male Speaker 2: ...center is doing to assess compliance with the new fiduciary obligations, and hopefully we will then leave some time for questions at the end of the presentation today.

So let's get started. As you know, because you're sitting here today, the Dodd-Frank Act made important changes to oversight of the municipal securities markets. Among other things, it provided that municipal advisors owe an express fiduciary duty to the municipal entities that they advise. The specific statutory writing is, "A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor's fiduciary duty or that is in contravention of any rule of the MSRB." So that's a lot, and we are going to try to unpack that for you this morning. I think it is on. And now? This is on. Great. So now we are all technologically ready to go.

Understanding your fiduciary duty is critical. It's a core of being a good municipal advisor, and while MSRB is in the process of issuing guidance -- and you are going to hear from Mike and Ben about the guidance in a few minutes -- it's generally recognized that a fiduciary duty encompasses both a duty of loyalty and a duty of care. Under the duty of loyalty, a

fiduciary is required to act in his or her client's best interest without regard to his or her own financial or other interests. It is also required to disclose conflicts of interest that might impair his or her ability to fulfill the duty of loyalty and not to undertake engagements in which those conflicts cannot be managed. Under the duty of care, a fiduciary must be qualified to undertake the engagement, take time to collect information about his or her client's needs, and consider whether a recommended transaction will serve the client's best interest.

And while our purpose today is to help you understand your legal requirements, I do want to take a minute just to give you an overall rule of thumb that I think is helpful in thinking about the issues. And I didn't come up with this. Lori Richards, one of our former heads of OCIE, in a speech to investment advisors back in 2006, said that in all likelihood you and your employees are going to get your fiduciary duties right if your decisions every day, large and small, are motivated by doing what is right by your clients. To keep this core fiduciary principle in mind, your clients should be well-served. Your friends will reduce your risk and, dare I say, avoid scandal.

Now, on the theme of doing what is right by your client, I'm going to take a few minutes to highlight a few key areas where market participants have not historically done right by their clients. Many of them involve outright alleged fraud or other abuses that I hope you will quickly recognize to be inconsistent with the fiduciary duties of loyalty and care. Let's start out with an area that is always near and dear to our hearts in Chicago: payoffs. In 2008, the commission filed a civil complaint against Birmingham Mayor Larry Langford; the chairman of a broker-dealer, William Blount; and their mutual friend, Albert LaPierre. The complaint alleged that while Langford served as president of the County Commission of Jefferson County, Alabama, he accepted more than \$156,000 in undisclosed cash and benefits over two years from Blount. In turn, Langford used his influence to select Blount's firm to participate in every Jefferson County municipal bond offering and security-based swap agreement during 2003 and 2004, earning his firm over \$6.7 million in fees. It was a very lucrative business for him, comprising over 70 percent of the firm's annual revenue for virtually no work on any of the transactions. Now, recognizing that it would be obviously inappropriate to hand an envelope of cash over to the mayor, the complaint alleged that Langford and Blount concealed the payments by using their longtime friend, LaPierre, an Alabama-registered political lobbyist, as a conduit. Now, it turned out that the payments between Blount and Langford were only part of a larger payment scheme that was allegedly being orchestrated by two directors of JPMorgan Securities.

In 2009, the commission filed a civil complaint against Charles LeCroy and Douglas MacFaddin and administrative proceedings against JPMorgan Securities. In these actions, the commission alleged that between October 2002 and November 2003, LeCroy and MacFaddin directed over \$8 million in payments from JPMorgan Securities to close friends of Jefferson County Commissions who either owned or worked at local broker-dealer firms. The local broker-dealers, including Blount's firm, had no official role and performed few, if any, services for the transactions. In connection with the payments, county commissioners, including Langford, voted to select JPMorgan Securities as managing underwriter and swap provider for the largest municipal auction rate securities and swap agreement transaction in JPMorgan's history.

Now, if you think about it just briefly, \$8 million in payments. Well, what did they get for that? What they got was billions of dollars -- up to \$5 billion in notional amount for the transactions they did. So, although the payments themselves were large, the amount of business scam result was extremely large. Although labeled as work on the transactions, the SEC alleged that LeCroy and MacFaddin knew that the payments were sham

transactions. How'd the SEC make that allegation? Well, there were taped conversations in which they were referred to as payoffs, the price of doing business and giving away free money. And of course, the firm incorporated the cost of the unlawful payments by charging Jefferson County higher interest rates on the swap transactions. On the cross, all of the three commission actions, the allegation was that the participants in the schemes failed to disclose any of the payments inherent in the conflicts of interest raised by them, either to the county or to investors, in the bond offerings or to the county in the relevant swap transactions.

So those are some, you know, payoffs, but let's talk about noncash payments. Let's talk about some entertainment. In 2012, the commission charged former Detroit officials and the investment advisor to the city pension funds in an influence peddling scheme. In that case, the commission filed a civil complaint against former Detroit Mayor Kwame Kilpatrick; former City Treasurer Jeffrey Beasley; and pension fund advisor MayfieldGentry and its CEO, Chauncey Mayfield, alleging that Kilpatrick and Beasley, who are trustees to the city pension funds, solicited and received \$125,000 or above private jet travel and other perks paid for by MayfieldGentry.

At the time, MayfieldGentry was recommending to trustees that the pension funds invest about \$117 million in real estate investment trusts controlled by the firm.

Female Speaker:

You are the first person to attend this meeting. To stop the music, press the star key.

[music]

[laughter]

Male Speaker 2: This segues back to the entertainment.

[laughter]

Michael Post: I don't know if this entertainment would influence me that much.

[laughter]

Male Speaker 2: So getting back to our story, the expenses clearly appeared to be entertainment related because they included items like \$40,000 some odd dollars for private jet travel for the entourage to fly out to Las Vegas, \$7,000 for hotel rooms at the Venetian Resort Hotel, \$2,700 in golfing fees, \$5,300 for private limousine service, and of course \$300 for Mr. Kilpatrick to get a massage because it's very stressful to use that much money for free. The commission alleged that Kilpatrick and Beasley and Mayfield did not tell anyone about the entertainment expenses at the time that the trustees were voting to invest \$117 million with Mayfield's firm.

However, I do want to caution you that entertainment does not need to be quite this extravagant, including trips to Las Vegas, to still raise potential fiduciary concerns. I wanted to highlight rating agency trips.

In 2009, the commission brought several administrative proceedings against RBC Capital Markets and Merchant Capital for advancing or reimbursing travel and entertainment expenses for city officials to travel to New York for meetings with rating agencies as part of the process of issuing bonds. So you had an official reason for making the travel. You were

going to discuss the bonds with your rating agencies. But according to the facts in the complaint, city officials traveled to New York with family members, and while they were there, family members went to entertainment and sporting events and had nice dinners, and it was reimbursed or the funds were advanced by the firms. And according to the complaint, after -- I mean according to the allegations, after receiving instructions from a representative of the city regarding the activities of interest to city officials and their families, RBC organized the activities for each trip and then advanced payment for nearly all of the expenses incurred by the city officials and their family members. RBC then obtained, with the knowledge and approval of city officials, reimbursement for all the expenses -- and you are going to recognize this schematic -- and of course they were billed through as a cost of issuance and taken from the bond proceeds at closing.

So, you know, I highlighted what I thought -- I hope are areas where you recognize an inherent problem with payments. As municipal advisors, you need to understand that any payments that you make to municipal officials directly or indirectly in cash in a payment or gift will raise fiduciary concerns. You also should understand that your receipt of anything of value from underwriters or other market participants who are seeking access to your municipal clients will raise similar fiduciary concerns. And the one other item I wanted to raise is to consider your duty in a situation in which you become aware of payments being made, even though you are not personally involved in the payments yourselves.

The next area I wanted to cover briefly falls under the general topic of giving advice without adequate training or failure to place your client's interests ahead of your own. And the one case I wanted to highlight in that area was advice to municipal school districts provided by Stifel Nicolaus. In 2011, the commission charged Stifel Nicolaus and his vice president, David Nowak, with defrauding five Wisconsin school districts by selling them unsuitably risky and complex investments funded largely with borrowed money. The complaint alleged that Stifel and Nowak created a proprietary program to help the school districts fund retiree benefits by investing in notes linked to the performance of synthetic collateralized debt obligations, synthetic CDOs, they alleged made sweeping assurances to the school districts that it would take 15 Enrons, meaning the catastrophic collapse of 15 investment-grade companies, for the investments to fail. In reality, the danger of losing the entire investment was significantly different and based upon much lower default rates than represented.

Other alleged issues included that certain CDO providers had expressed concerns about the investments, such as the heavy use of leverage in connection with sales to municipal school district and -- districts, and some of them had actually declined to participate. Other things that were allegedly not disclosed were that the portfolio in the first transaction in a series of transactions performed poorly right from the outset. And not surprisingly in this case, all of the investments failed. School districts lost not only the entire principle they invested, but they had borrowed heavily and lost that money as well. The commission, in this particular case, also brought several administrative proceedings against RBC Capital Markets for selling the CDOs to school districts in the first place. And when taking a look at the allegations against both Stifel and RBC, I just thought it was interesting to note that in the allegations, there is a flavor of both RBC and Stifel trying to pass the buck between each other as to who was responsible for properly explaining and assessing the suitability of the investments to the school districts in the first place.

I think it is important that as municipal advisors, you understand that to the extent that this is within the scope of your engagement, that buck is going to stop with you in helping your client to assess the suitability of the transactions that you are recommending. And, you know, the takeaway here, I think, is that it is important to understand that you need to assess your qualifications to undertake advice, particularly on complex and risky products.

Make sure you take the time to understand your client's needs and objectives. And make sure that the product meets their needs and objectives.

One other area I wanted to cover briefly was disclosure cases and particularly in the context of a series of commission proceedings that have been filed against state issuers for failure to disclose adequately underfunded pension liabilities in connection with bond offerings. In the last two years, the commission has brought cases against both the state of Illinois and the state of Kansas, and the issues in the cases have involved complex historical structural underfunding problems with both states. They've involved miscommunications between various state agencies on who's responsible for making the perfect disclosures. And it involved, at times, complex actuarial accounting issues. And I raise those topics because to the extent that you have been retained to assist an issuer in assessing its disclosures in connection with an official statement, keep in mind that pension liabilities are on the radar. They're complex. And make sure that you are taking appropriate steps to understand and assess the issues with your municipal clients. And the takeaway from the administrative proceeding in Illinois that I wanted to share with you was what the commission said in that case, it was relying on prior carryover disclosures and Page-Turner reviews during group conference calls. The state and its advisors did not scrutinize the institutionalized description of the pension plan funding adequately and made little affirmative effort to collect potentially pertinent information from knowledgeable sources, in particular actuaries for the hedge and systems and the states' Commission on Government Forecasting and Accountability.

The last claim I wanted to touch on briefly before turning it over to Michael and Benjamin is the issue of lying about your qualifications when seeking municipal business. Over time, the commission has brought a number of actions against investment advisors for exaggerating asset center management or exaggerating a client base. One particular case I wanted to point out quickly was that in 2013 the commission brought civil administrative proceedings against the CEO of an investment advisory firm for lying to CalPERS and other current and potential clients about the amount of money being managed by the firm. The CEO falsely certified to CalPERS that his firm met its minimum AUM requirement and, once gaining the CalPERS business, went on to tout that relationship with other clients. So, you know, in your situation, obviously, being accurate in your representations about who your client base is and what your qualifications are is going to be very important moving forward.

At this point, having laid the groundwork for what I hope examples [inaudible] in fiduciary duties, I'm going to turn over to Michael and Ben and talk to you about guidance and helping you avoid such catastrophic problems as you structure your agreements with your clients.

Michael Post: Thank you, Tom. We'll talk about the MSRB's draft rule G-42 and some detail about where it is in the overall rulemaking process. It's important to bear in mind -- well, I think you'll see as we go into some of the detailed provisions of the draft that they follow some of these broad categories that Tom has described have occurred in cases, at least for investment advisors in particular, that also owe a fiduciary duty to their clients. But it's important to bear in mind that the fiduciary duty of a municipal advisor to a municipal entity client is imposed by Dodd-Frank, and a breach of that duty is a violation of Dodd-Frank, even if the very particular issue isn't addressed by an MSRB rule. So G-42 is really an effort by the Board to provide guidance on some of the subjects that it is anticipated will come up most frequently.

But in the debate about whether regulations should be principles based or more prescriptive, principles based being more flexible and then prescriptive potentially providing

greater clarity to market participants, I think that the fiduciary duty standard in Dodd-Frank itself is probably the most general sort of flexible principle in existence in financial services regulation. So that is important to bear in mind. The Board, since the SEC's adoption of a final definition of municipal advisor last September, has been developing and prioritizing this core standards and core duties rule. So in January, the board published a draft rule and received 44 comments on it. And after carefully considering the comments and considering changes to the draft in response to them, the board determined to re-propose a revised draft rule and received another 19 comments on that. The commenters seemed to generally welcome the board's effort to re-propose and seek additional input and generally welcomed many of the revisions that have been made compared with the initial draft rule. And the Board has considered those additional comments and the draft rule overall and the next step that you can anticipate would be the Board filing a proposed rule with the Securities and Exchange Commission. There will be another comment period at the SEC level in that process and the proposed rule could change yet again in response to those comments if the Board determines to file an amendment to the proposed rule. So what we'll do today is we'll talk about the last public draft rule with the caveat that it's still in process and may change based on the Board's recent consideration of the second round of comments and may change even further in the rulemaking process at the SEC. But I think that it will be instructive nevertheless because the provisions that we'll describe will raise for you most of the kind of significant issues that arise and, I think, give you a sense, I hope, at least for the rationale of the Board to date to try to address some of the things that it was anticipated will come up most frequently.

So the initial sections of the rule provide for the core standards of conduct, and as mentioned by Tom, the Board has broad regulatory -- broad rulemaking authority over municipal advisors to prevent fraudulent and manipulative practices, but it also has authority to

-- to adopt rules reasonably designed to prevent actions that are inconsistent with the statutory fiduciary duty. The rule sets forth the basic standards and brings these relationships, I think, into kind of the sphere of regulated relationships elsewhere in the financial services industry. So if you think about a broker/customer, investment advisor/client, and now with municipal advisor/client, the rule speaks to some of the things like the disclosure to the client of all material conflicts of interest, the documentation of the relationship, the making of only suitable recommendations, the standards for reviewing the recommendations that may be made to the client by others, and addressing the subject of principle transactions. And then there are some other specific prohibitions in the draft rule related to compensation and fees, payments to obtain or retain business, and other matters.

The duties in the draft rule are non-exhaustive on several levels. There's the broad principle in the statutory fiduciary duty, I mentioned, and the rule also -- the draft rule says that its requirements don't displace any more restrictive requirements in state law or other law. So it will be important to consider, even if something isn't specifically addressed by G-42, if adopted, to consider other sources of law that might apply to your activities, namely state and other law. The rule provides that each municipal advisor in the conduct of municipal advisory activities for obligated person clients, owes a duty of care and a municipal advisor advising a municipal entity client owes the fiduciary duty, which will include a duty of care and a duty of loyalty.

The duty of care: There is some guidance on what, at a minimum, the duty of care encompasses and there's a requirement that the advisor possess the degree of knowledge and expertise necessary to provide its client with informed advice. There also is a draft requirement to make reasonable inquiry as to the facts that are relevant to a client's

determination whether to proceed with a course of action or the facts that form the base of advice provided to the client. And there is a draft requirement to conduct a reasonable investigation to determine that -- to determine that the municipal advisor is not basing a recommendation on materially inaccurate or incomplete information. There is some guidance on the duty of loyalty that it at a minimum would require the municipal advisor to deal honestly and in the utmost good faith with its client and to act in the client's best interests, irrespective of the financial or other interests of the municipal advisor. A municipal advisor to a municipal entity client would be required to eliminate or provide full and fair disclosure of each material conflict of interest, and the duty of loyalty would preclude a municipal advisor from engaging in municipal advisory activities with a particular client if it couldn't manage or mitigate its conflicts of interest in a way that would permit it to act in the municipal entity's best interest.

So those are some of the basic standards, and I gave you an overview of some of the different aspects of the proposed regulation of this relationship. I'll turn it over to Ben to talk about -- in detail about the provisions on the disclosure of conflicts of interest and the documentation of the relationship.

Ben Tecmire: Thanks, Mike. Like Mike mentioned earlier, the rule contains provisions regarding disclosure of conflicts of interest. It is an important part of many of the profession's fiduciary duties as it is a part of -- will be called part of the municipal advisor -- sorry -- regulatory regime. In the area of disclosures at or prior to engaging in municipal advisory activities, an advisor would need to fully and fairly disclose its -- disclose to its client, in writing, all material conflicts of interest. Disclosures would need to be sufficiently detailed to inform the client of the nature, implications, and potential consequences of each conflict. Such disclosures would also need to include an explanation of how the advisor addresses or intends to manage or mitigate each conflict.

As currently drafted, material conflicts would include actual or potential conflicts of interests that could reasonably be anticipated to impair the advisors ability to render unbiased and competent advice to or on behalf of the obligated person client or fulfill its fiduciary duty to its municipal entity client. Material conflicts would also include advice, services, or products provided to or on behalf of the client by an affiliate of the municipal advisor if related to the municipal advisory activities, also payments to obtain or retain the client's municipal advisory business or payments received from third parties to enlist the municipal advisor's recommendation of its services or any transactions or financial products. Conflicts that may arise from compensation from advisory activities -- that is contingent on the size or closing of any transaction to which a municipal advisor is providing advice -- may also be a conflict -- material conflict. Draft rule would require municipal advisor to disclose to the client any legal or disciplinary events that are material to a client's evaluation of the municipal advisor or the integrity of its management or advisor personnel. Lastly, the draft rule would also require disclosure of other engagements and relationships of the municipal advisor that might reasonably impair the advisor's ability to either render unbiased advice or competent advice to its client or to fulfill its fiduciary duty. If a municipal advisor concludes that it has no known material conflict of interest based on an exercise of reasonable diligence by the advisor, the municipal advisor must provide documentation to the client to that effect.

During the first public comment process, some commenters raised concerns that initial draft rule failed to adequately address issues associated with the provisions of inadvertent or incidental advice which may cause a firm to be considered a municipal advisor under SEC rules. Commenters observed that a firm could render advice and trigger the application of certain provisions of the initial draft rule absent a decision by the firm and the prospective client to enter into a client -- municipal advisory client relationship. This could implicate the

application of requirements to disclose conflicts of interest and requirements for the documentation of the municipal advisory relationship.

In response to these commenters and comments, supplementary material has been added to help address some practical issues related to the timing for conflicts disclosure and the documentation of the relationship. In the last current public draft of the rule, in the event of a municipal advisor inadvertently engages in municipal advisory activity and does not intend to continue the municipal advisory activities or enter into an advisory relationship, the advisor would be required to properly provide a dated document that includes a disclaimer that the advisor did not intend to provide advice and that effective immediately has ceased engaging in municipal advisory activities. Also a notification that such municipal entity or obligated person should be aware that the disclosure of material conflicts of interest and other information as required by the rule have not been provided. It must also include a representation that the advisor has in good faith undertaken reasonable efforts to identify the advice it has inadvertently provided. Finally, request confirmation that the municipal entity or obligated person received the documentation. An advisor is also required to conduct a review of its supervisory and compliance policies and procedures for the purpose of ensuring that the reasonably designed to prevent inadvertent advice to municipal entities and obligated persons. To be clear, this provision of the rule would not serve as a safe harbor from a violation of SEC municipal advisor registration rules or MSRB registration rules.

Next, we've elected to discuss the documentation associated with the municipal advisory relationship that would be required under the draft rule. So under the draft rule, municipal advisors must evidence each of their municipal advisory relationships in writing prior to, upon or promptly after the establishment of that relationship. The provision of the requirement would not require a contract be created and would not necessitate or replacement of an existing contract between a municipal advisor and its client. The writing would only need to require -- would only require to be delivered to the client and would not need to be signed by the client. Some of the information that must be included in this documentation of the municipal advisory relationship are the form and basis of any direct or indirect compensation, description of the type of information regarding legal or disciplinary events requested by the SEC on Form MA and Form MA-I, and information identifying where the client can electronically access the most recent Form MA and each most recent Form MA-I. It must also include the date of the last material change to a legal or disciplinary event on the Form MA or Form MA-I filed with the SEC. Also it must include the scope of activities to be performed and any limitations on the scope of the engagement. Also it must include the date, triggering event, or means for the termination of the municipal advisory relationship or, if none, a statement that there is none and any terms related to the withdrawal from the municipal advisory relationship. During the terms of the municipal advisory relationship, documentation of the advisory relationship must be promptly amended and supplemented only if there is a material change or addition. Finally, the documentation must be promptly -- then promptly delivered to the client. I am going to turn it over to Mike, and I apologize if it is a little robotic, but there is a lot of detail that we want to make sure that we convey. So...

Michael Post: A couple of observations about the sections that Ben detailed: The provision for the inadvertent advice is there, and the rationale was that if a person has provided inadvertent advice and perhaps wasn't registered, there are already compliance issues that that step has triggered without the person also having to be potentially in violation of an MSRB rule because they didn't disclose conflicts beforehand and because they didn't document a relationship that people didn't intend to create in the first place. So it really is

an effort to sort of tailor the requirements and not impose burdens or potentially additional rule violations where they wouldn't make sense. Let's see. I had another observation. Perhaps it will come to me.

So I'll move on to the suitability of recommendations and the review of recommendations of others. For -- the draft rule has a fairly detailed provision on this subject, and again, this is -- for those of you familiar with suitability obligations of the broker-dealer or suitability obligations for market participants regulated by the CFTC, a lot of this will sound very familiar. So a municipal advisor, under the draft rule, that makes a recommendation of a municipal securities transaction or municipal financial product or reviews the recommendation of another party, if requested by the municipal entity or obligated person client and it is within the scope of the engagement, must determine based on information obtained through reasonable diligence whether the recommended transaction or financial product is suitable for the client. And a determination of whether the transaction or product is suitable must be based on a list of several factors, including the client's financial situation and needs, the client's objectives, risk tolerance, liquidity needs, experience with municipal securities transactions or municipal financial products generally or of the type and complexity being recommended, the financial capacity of the client to withstand changes in market conditions during the term of the product or the period in which the municipal securities are expected to be outstanding, and any other material information known by the municipal advisor about the client and the municipal securities transaction or product after reasonable inquiry.

In addition to this determination of whether the transaction or product is suitable, the municipal advisor would then be required to inform the client about the material risk and benefits of the transaction and its structure, the basis on which the municipal advisor believes that the transaction or product is suitable or not, and whether the municipal advisor considered reasonably feasible alternatives that could have also -- could also serve the client's objectives.

Again, like FINRA requirements related to the suitability obligation and CFTC requirements similarly related, there's a know-your-customer -- or know-your-client requirement analogous to the know-your-customer requirement. And under that, a municipal advisor would be required to use reasonable diligence in regard to the maintenance of the municipal advisory relationship to know and retain the essential facts concerning the client and concerning the authority of each person acting on behalf of such client. And the essential facts, for purposes of knowing your client, include those that are required to effectively service the municipal advisory relationship with the client; to act in accordance with any special directions from the client; understand the authority of each person acting on behalf of the client; and comply with applicable laws, regulations, and rules. The draft rule requires -- it has a diligence standard in connection with each kind of undertaking, whether it be making a recommendation or reviewing the recommendations of others. And there's a kind of overarching principle that the client is empowered to control the scope of the relationship.

So the review of the recommendations of others, for example, only triggers obligations on the part of the municipal advisor if it is within the scope of the relationship. And you'll recognize that these provisions about reviewing of recommendations of others can dovetail nicely with the IRMA exemption that is provided under the SEC final registration rule.

So I'll discuss one of the specific prohibitions, and that's related to principal transactions with your client. And there was a proposal in the initial draft rule to prohibit principal transactions with the client and the -- a number of comments addressed that subject in the

first round and sought clarity about the scope of the prohibition. So the revised draft rule significantly narrows and clarifies the scope of the prohibition. There was some concern that a principal transaction -- even though there was reference in the rule to the client being a counter party, for example -- might encompass the mere provision of professional services and receipt of payment for those professional services or could include very basic banking products like cash deposit accounts. So the draft rule continues to provide that a municipal advisor would be prohibited from engaging in principal transactions with a client. It's limited to municipal entity clients to which the municipal advisor would owe a fiduciary duty under Dodd-Frank. But it's important to note that municipal advisors in their dealings really with all persons are already subject to MSRB Rule G-17, which is the kind of fundamental or basic fair-dealing rule. In response to the comments the Board provided in the revised draft a definition of engaging in a principal transaction and drew on some of the language in the Investment Advisors Act addressing principal transactions between investment advisers and their clients. And so it defines those transactions as acting as a principal for one's own account, selling to or purchasing from the municipal entity client any security, or entering into any derivative, guaranteed investment contract, or other similar financial product.

So now I'll discuss some of the other specific prohibitions related to compensation fees and some other matters. So there are specific prohibitions in the draft rule against excessive compensation in relation to the municipal advisor services that were actually performed. And in response to comments, the revised draft rule adds supplementary material to give guidance on the factors that would be considered in determining whether compensation is excessive, and those factors are derived largely from existing MSRB guidance on excessive compensation for dealers. Those factors are: the municipal advisor's level of expertise, the complexity of the municipal securities transaction or financial product that was being advised on, whether the municipal advisor's fee is contingent upon the closing of the transaction or financial product, length of time spent on the engagement, and whether the advisor is paying any other relevant costs related to the transaction or financial product. There's a specific provision that would prohibit municipal advisors from delivering an invoice for fees or expenses for municipal advisory activities that does not accurately reflect the services performed or the personnel that performed those services. But in response to comments, there is clarification in the re-proposal that the draft rule wouldn't prohibit a municipal advisor from providing a discount of the fee as compared to the services that were actually performed as long as that discount is openly disclosed to the client. The municipal advisor would be prohibited from making payments for the purpose of obtaining or retaining business to any person other than reasonable fees that are paid to another registered municipal advisor for solicitation of a municipal entity or obligated person. And this is in recognition of the Dodd-Frank Act -- Dodd-Frank Act's grant of rulemaking authority to the MSRB over municipal advisors that undertake solicitations of municipal entities. Otherwise, draft G-42 is speaking to the core standards of conduct or core duties of non-solicitor municipal advisors, and the MSRB anticipates taking up the issue of the duties of solicitors in a separate rulemaking initiative. There is also a specific prohibition on the making of materially false or misleading representation about the capacity, resources, or knowledge of the municipal advisor to obtain or retain municipal advisory business.

So that concludes the overview of the provisions of the draft rule G-42. I'd caution again that the rule is still in process and subject to change, but we hope that that overview at least raises flags or raises some of the issues that you can anticipate an eventual rule addressing and to prompt any questions that you may have. And I think at this time, I'll turn it back to Tom to keep us on track.

Male Speaker 2: Great. At this point, I'm going to turn over to Bonnie, who is going to provide a little bit of flavor for what FINRA is currently doing in assessing and reviewing

fiduciary obligations during their examinations.

Female Speaker 1: Okay. Thanks, Tom. And we've certainly gone from the SEC starting us off with some cases of real failure to the MSRB on their role and ways to avoid it, and we thought it would be helpful to talk about what FINRA examination staff may do in reviewing municipal advisory activity in advance of rulemaking but currently while your activity is going on. And for the folks in the room or also listening on the webcast, you know, some of the techniques and questions that an examiner may use may be helpful for you to use thinking about your own business activities and particularly the fiduciary obligation that arises out of undertaking a municipal advisory activity.

Now, as Ed Wegener mentioned at the -- in his opening remarks, FINRA, we're the organization that examines broker-dealers. But we think that some of these questions and techniques may apply across the board. One of the first steps an examiner will do when he or she arrives at your firm or is in contact with you is really focus on where you are acting as a municipal advisor and identify those engagements. That's where you are going to owe the municipal entity a fiduciary obligation. This obligation arises either when you're getting advice or recommendation on the issuance of securities or on investment strategies and for the broker-dealers in audience it's typically when your purchasing, selling, making recommendations about securities on the investment of proceeds or brokerage of escrow receipts.

So here are three sample questions that FINRA examiners may ask, and this will help you think about your own obligations: The first is does your firm have a reasonable means to determine the circumstances under which you are acting as a municipal advisor? For example how does your firm identify when it is making a recommendation or giving advice to a municipal entity? And in fact, I could have thrown in here how do you identify your municipal entity clients -- separate them from your others, because that's when the municipal limit of fiduciary obligation attaches. But once you are hired as a municipal advisor, how do you and your employees meet your fiduciary duty for the length of the engagement? In other words what does it mean in your firm to have a duty of care and to meet the duty of loyalty? How do you identify conflicts of interest -- there certainly was a lot of talk about that -- manage them and then disclose them to the municipal entity? So in short the communications that you have with your customers, the training you do with your employees, your policies, your procedures, your supervision -- it all has to be consistent and aligned reflecting how you think about and answer these types of questions about your fiduciary obligations.

Male Speaker 2: And I'd like to mention that while Bonnie is speaking about examinations that FINRA is conducting broker-dealer municipal advisor's, I think the approach is likely to be applicable to all investment advisors. So, you know, think about those questions in general. And I was wondering, Bonnie, if there are any illustrative examples that you may have from recent exams that may help flesh this out a little bit?

Female Speaker 1: We do, Tom. And it's interesting. It does involve what we affectionately call an IRMA. I didn't realize that was controversial. It is awfully hard to spit out the rest of it. And -- but there were a lot of questions about that this morning and in this example it doesn't matter whether you are the broker-dealer or the municipal advisor. Everyone was at fault. It is really a cautionary tale and it is a practice that should be avoided. In this case we had a broker-dealer that wanted to rely on one of those exemptions -- the IRMA exemption. And so you'll recall from Jessica's remarks that that means that an independent registered municipal advisor had been hired by the issuer to provide advice and so the broker-dealer was going to be providing advice on the investment

of proceeds on purchasing and selling some securities. It might have been treasuries or mortgage specs. And that would have been perfectly fine.

Now let's stop for a minute. Why would a broker-dealer want to avail itself of that exemption? Well, as Mike mentioned, if you are a municipal advisor you can't engage in under the draft rule should it pass -- you can't engage in principle transactions. And so we already have some firms that are -- you know -- avoiding that by hiring -- ensuring that an independent registered municipal advisor is hired. And so that was the reason.

However, in this case, the IRMA was not standing side by side, as John Cross had said. This IRMA was -- to continue that illustration -- sort of sitting in the corner. The IRMA had been hired, but really the hiring was just to give a façade of independence. It wasn't actually evaluating the recommendations being given by the broker-dealer, and it wasn't giving any advice on the quality of those securities to the municipal entity. Now, in this example, both the municipal advisor and the broker-dealer were at fault. The municipal advisor failed in its fiduciary obligation to the municipal entity, and in addition, the broker-dealer failed to perfect its reliance on that regulatory exemption. And whether you're at the broker-dealer or at a municipal advisor, don't let this happen at your firm.

Male Speaker 2:

I think we still have a few minutes left, and I wanted to get to questions because they've been coming up pretty fast and furious now. So let's see if we can go ahead and address a couple of the questions right now. The first question was: "Financial advisory contracts often provide for a compensation on a per bond basis upon the successful completion of a transaction like the issuance of bonds. Is this still consistent with the new fiduciary standards?"

Michael Post: Yes, it is consistent with the draft rule, you know, with the caution it's still in process, but the -- really that issue -- raises potential conflicts of interest related with that form of compensation. And so the draft rule would simply require full and fair disclosure of that material potential conflict of interest, recognizing that in that instance, the municipal advisor may be incentivized to provide advice that makes it more likely that the transaction is going to close or more likely that it's a larger transaction if the fee is on a per-bond basis. And it would -- it would really be then -- the client would be well-informed about those potentials, and there isn't any other -- you know, solely based on that, there isn't any reason that the relationship can't continue and that it can't be productive and a beneficial one to the client. But the conflicts of interest would be important to be disclosed.

Male Speaker 2: Moving on. Additional questions, then. The next questions relate to can we, as a panel, provide some flavor for the documentation of the know-your-customer suitability-type documentation that we would expect to see in terms of either the rule or from an examination perspective.

Female Speaker 1: I can start it. I can start that. With a municipal entity, if you've dealt with them before, you know that they are typically governed. They have statutory restrictions as well as local investment guidelines. Those are two good places to start as well as getting the trading authorization to determine that the person with whom you're transacting is permitted to do so. That's really a start. Obviously your own suitability guidelines at your own firm should apply. Want to add anything to that?

Michael Post: I would just add, I suppose, that there's going to be a difference between record requirements that are very specifically prescribed by MSRB rules and then uses of

records that would be prudent for municipal advisors and -- you know -- worthwhile in the exercise of your own business judgment. So the SEC has already adopted, in the final registration rules, a host of books and records requirements. So I would urge you to consult those because they already are addressing the communications sent and received by the municipal advisor in the course of its business. There are some additional proposed books and records requirements in the [MSRB's] rules, but really, they're focusing on specific requirements in each kind of targeted rule, whether it be the proposed supervision rule or

G-42 or the proposed gifts rule. But a lot of the general or kind of foundational books and record requirements, I think you'll find in the SEC final rules.

Male Speaker 2: Another frequent question that we're getting is some confusion amongst the suitability obligation versus fiduciary standard -- you know, why is there a suitability obligation in place when, arguably, the fiduciary standard of acting in the best interest of the client could cover the entire world here?

Michael Post: Sure. The suitability standard is there because -- well, it will be important in that it will be the minimum standard, at least for municipal advisors when they are dealing with obligated person clients. So the MSRB has followed the approach that, you know -- signaled in Dodd-Frank--that a fiduciary duty is owed to municipal entity clients and not obligated to person clients. Even though the MSRB was granted fairly sweeping rulemaking authority, it has not proposed to impose a fiduciary duty on municipal advisors when they're dealing with obligated person clients.

So the -- it's true the fiduciary duty is going to be -- and I think it's recognized elsewhere in financial services regulation -- a higher standard than a suitability standard because the municipal advisor shouldn't simply make recommendations that are suitable for the client; the municipal advisor should only make recommendations that are in the best interests of the client. But the suitability standard is still important in the rule for the recommendations to obligated person clients to which a fiduciary duty is not owed.

Male Speaker 2: And Michael, can you give a little bit of flavor for a situation in which there may be a range of potentially suitable structures that a municipal entity might pursue? How does the -- how does the municipal advisor handle that type of situation while still satisfying their fiduciary duty?

Michael Post: I think, typically, the municipal advisor is going to -- I would anticipate, going to make a singular recommendation. But the draft rule contemplates the potential for there to be other alternatives that could serve the client's objectives. And there was, you know, in the earlier proposal -- or at times, there was consideration given to imposing an obligation on municipal advisors to discuss the reasonable alternatives. But there's been an overarching approach in the MSRB's development of the rule, really, to allow the municipal advisor and the client to largely arrange the relationship between them. And this goes a long way towards empowering the client. It also goes a long way towards giving the municipal advisor some clarity about the obligations that it would have. So while the rule wouldn't permit a municipal advisor to vary the duties that it would owe within the scope of the relationship, it does allow the issuer and -- or the client and the municipal advisor to define the scope of the engagement. So the rule still has what, I guess, you could consider a sort of a prompting or a flagging because when a recommendation is made, there's a draft requirement, a proposed requirement, that the municipal advisor inform the client whether it has considered other reasonably feasible alternatives that would serve its objectives.

And so I think the anticipation is that that would at least prompt the conversation if the client expected the -- a range of alternatives to be considered and they weren't, the client

would be informed at that point that the municipal advisor did not consider alternatives. If the client didn't expect alternatives to be considered, didn't view itself as compensating the municipal advisor fairly for that broader scope of engagement, then the client, presumably, wouldn't be surprised when at that stage it's informed that the municipal advisor didn't consider alternatives.

Male Speaker 2: We also have a variety of questions that generally deal with the intersection between political contributions and potential problems with that raising fiduciary duty type conflicts of interest. Can you just speak about how to handle that type of situation? Is -- are political contributions going to breach fiduciary duties? Is there a way that they should be handled?

Michael Post: Well, there are provisions in the draft rule that speak to payments made. There's a prohibition in the draft on payments made to obtain or retain business except for, you know, in certain circumstances-- for example, to another registered municipal advisor for solicitation, recognizing that a soliciting municipal advisor is subject to the regulatory framework that is currently in place and in the process of being developed, namely, registration requirements, rule G-17, there are proposed amendments to G-37 that would bring that soliciting municipal advisor under the applicability of those provisions, a proposed gifts rule, a supervision rule that has already been approved, and is -- would be implemented in April of next year.

So there is a rationale for the exception for those payments to a registered solicitor municipal advisor, but otherwise payments to obtain or retain business, which political contributions in some circumstances could fit into, would be prohibited by the draft rule G-42. But the MSRB's existing rule G-37 on political contributions is in the process of being proposed to be extended to municipal advisors.

So the same basic approach in the rule where a triggering contribution by a municipal finance professional at a broker-dealer, or the dealer, or a PAC controlled by either of those, would result in a ban on municipal securities business by that dealer with the relevant municipal entity for two years. And this is a -- it could be characterized as sort of a cooling off period to sever -- or sever the potential connection between the contribution and political favors, or at least the appearance of a connection between the contribution and the political favors.

So the -- in -- I guess, in sum, there are provisions in draft G-42 on payments to obtain or retain business. And the MSRB is in the process of proposing to apply the core elements of G-37 to municipal advisors as well.

Male Speaker 2: To round off our hour, because we're about finished, I just had two more questions which relate to the form of the engagement agreements. The first one is: Does MSRB anticipate and provide any guidance or templates for a standard engagement agreement?

Michael Post: The MSRB is -- does not plan to provide a template. I think a major rationale would be some of the things that I alluded to earlier that there's the overarching goal, really, to empower the client, and to allow the client and the municipal advisor to the extent it would be appropriate to arrange their relationship and arrange the dealings between them.

So rather than the MSRB suggest that the scope of that relationship should be in any particular form, it really will be up to the parties to the relationship to do that. But one

thing I wanted to emphasize, again, is that the documentation that the draft rule would require is not necessarily a two-party agreement. Such an agreement would comply with the rule, you know, if it met -- if it covered the topics that are required to be evidenced in the documentation of the relationship. But the documentation of the relationship can be unilaterally prepared by the municipal advisor. Of course it would be -- it would need to be accurate. So to the extent that it -- to the extent it describes the terms of the relationship with the client, those would have to be the actual terms that are the agreement or understanding between the municipal advisor and the client. And the writing that's created to document the relationship would need to be updated and provided to the client.

But the approach in the draft rule thus far has not to be -- not to require a contract, or agreement, per se, or bilateral agreement. And our understanding has been that in some jurisdictions, the -- you know, a two-party agreement or a contract might not necessarily be required by the local procurement law or local procurement regulations. So the MSRB did not want to impose, based on its development of the rule so far, a requirement that would go beyond, sort of, the locally applicable procurement regulations.

Male Speaker 2: And one last question on written contracts. The question was, "Is it going to violate proposed G-42 for a municipal advisor to give advice to a prior client before entering into a new contract?" And the specific example would be, for example, to implement a refunding.

Michael Post: Well, if I understand the question, I think a fiduciary even, you know, this -- assuming maybe municipal entity clients, you know, if you draw analogy perhaps to attorneys there are instances where attorneys represent multiple parties in the same matter, in the same transaction, and it may not be problematic so long as the different parties' interests are aligned. But it's common for, you know, in an attorney -- in the attorney area if the interests of the parties -- multiple clients of an attorney begin to diverge, than the attorney would need to sort of spin off one or more of the clients to a separate attorney.

So I think that if the interests of the different clients of the municipal advisor or potential clients are aligned, then at least in the development of the draft rule so far nothing would prohibit the municipal advisor from representing multiple parties. So I would just caution, based on an analogy to attorneys, that if the different parties' interests were materially different, or over time did diverge, it might be important for the municipal advisor to consider sort of spinning off one of the -- one or more of the clients to another municipal advisor, or another sort of arrangement that would be satisfactory to the former client.

Male Speaker 2: Well, with that answer, I think we are now a little bit over our allotted time. So I have just a few quick housekeeping items as we finish up our panel, the first one being that CPA forms are in the back of the room, right in the center, for anyone who wants to take advantage of that. Oh, what'd I say? CPE.

[laughter]

CE forms, unless you want to be a CPA by filling out a form.

[laughter]

In addition, I wanted to let you know that lunch is not being specifically provided out here. But the fed does have a good cafeteria on the fifth floor, has a variety of different options -- grill, salad, hot plates. I'm not getting a cut for pitching their business, but it's good food.

[laughter]

And finally, I wanted to remind you that, to the extent that you choose to go outside of the building to have lunch, we are going to start panel three promptly at 1:30 p.m. And please make sure that you leave time because you're going to have to go back through security to get back into the building. With that, thank you very much, and we'll see you after lunch.

[applause]

Dan Gregus: Good afternoon, everyone. My name is Dan Gregus. I am the acting associate director for Broker-Dealer Examinations in the Chicago Regional Office of the SEC. And I am honored to have with me today Larry Sandor, the deputy general counsel of the MSRB, as well as Laura Trotz, the deputy district director of FINRA's Chicago district office. We're going to be talking about municipal advisors, supervisory, and recordkeeping responsibilities.

Before we start, I just -- we wanted to remind you that during the presentation, members of the SEC staff will be walking around to take questions that you might want to present to the panel near the end of our discussion.

So supervisory responsibilities, and what will we be talking about? I'll be talking about the SEC's standard of supervision, which is very general, and the records that the SEC requires you to keep.

The MSRB has been designated the primary rule making authority in the area of supervision of municipal advisors and so Larry will be talking to you about more specific rules that they'll have in this area, including the recently approved rule G-44 and the corresponding amendments to rules G-8 and G-9. For most of you, your first contact with your regulators and their interpretation of the rules as they apply to you will probably be in examinations. As you may or may not know, the SEC will be examining municipal advisors that are not members of FINRA -- essentially, independent municipal advisors and municipal advisors that are also registered as IAs. We'll hear more about that in the next panel.

FINRA will be examining municipal advisors that are also members of FINRA, so, essentially, broker-dealer municipal advisors. Laura Trotz will be talking about what FINRA will be looking for in this area based on her experience dealing with registrants of that type. So let's get to the SEC standard.

The SEC standard can be found in Section 15(b) of the Securities Exchange Act. It really says that your firm needs to have procedures that are reasonably designed and implemented in order to prevent and detect violations of the Federal Securities Laws and the MSRB rules. This is very general and gives you some flexibility in doing so.

So let me tell you, very generally, what it is that we'll be looking for over there. As I said, there'll be more details on this in the next panel. But when we come into one of your offices, we'll be looking for a set of procedures. These procedures should be customized to your firm's business and not off the shelf. Or if you've bought something that's off the shelf, make sure you customize it to your business. There's nothing surer than if we find some off-the-shelf procedures where a firm has forgotten to change the name of the firm on the procedures --

[laughter]

-- for us to not be likely to find that they're reasonably designed to be customized to your business.

Secondly, we're going to be looking at implementation. And in the area of implementation, one of the most important things to show that you've implemented these procedures is your documentation, which falls right into the rest of our presentation. This is one of the best ways to show that you've implemented the processes that you have designed in your procedures.

Now, before I get to that, let me tell you that rule 15-B derives from -- or this standard derives from Section 15(b)4 and 15(b)6 of the Exchange Act, which provide that a firm and an individual can be sanctioned for failing reasonably to supervise a person under their supervision. This mostly applies to business line supervisors, but I will call your attention to a fairly recent case still that was brought through the Chicago office called the Ted Urban case, where, essentially, this case found that pretty much anyone in management can be deemed a supervisor, someone in compliance, a lawyer, possibly even a CEO or president. But this is not solely based on your title. It's only if you are designated or undertake a supervisor role or can otherwise affect a conduct in question, such as by hiring and firing. And through some of the later discussion today, you'll -- what -- we'll talk about designating people in this area. So I thought that would be interesting to you. You can find that in the -- on the SEC's website under Administrative Proceedings.

So now that I bring that up, I will talk about recordkeeping in a little more detail and to -- hopefully, to help you assure that you're in compliance with your responsibilities. SEC Rule 15-B 1-8 sets forth the recordkeeping requirements for municipal advisors. I'm going to go over the areas that it requires pretty quickly because the list can be found in the rule and you can check it back and it's pretty straight forward. And I want to be able to focus on a couple of other concepts pertaining to this recordkeeping. They're not really discussed in the rule or not very specifically discussed in the rule but can be found in the release which is in much more detail in the CFR section.

So the first thing that you need to keep are communications sent and received by the firm. You'll find in the rule that this also includes internal communications. In the CFI you'll find that this also should include electronic communications. That includes communications on your websites, in your emails and instant messaging. This can be found specifically at page 397 of the CFR in footnote 1341. So see how much time I'm saving you already?

[laughter]

You also have to keep and produce checkbooks, bank statements, ledgers, and other financial records. In addition to that, you must keep and produce every version of policies and procedures that you had in place in the last five years. And when I say the last five years here, it's important for you to remember that for the future. But the last five years here means everything after July 1st, 2014, whenever -- I say that because that's the effective date of the procedures.

In addition to those procedures, keeping those procedures for five years, you have to keep them for the first two in an easily accessible place. And remember that concept because it comes up a couple times out in this rule, and it is defined by how quickly you have to produce these records. You need to keep documents material to your recommendation or anything that memorializes your recommendation. You also have to keep all written agreements with municipalities, their employees, or obligated persons. And Mr. Cross described what obligated persons are: essentially, a fancy name for municipal conduit

borrowers.

On top of these records, you need to keep lists, lists of all associated persons with your firm in the last five years, lists of all municipalities and obligated persons who engage your services in the last five years, anyone that the municipal advisor paid to solicit municipal business on its behalf or anyone who paid the municipal advisor to solicit municipal business for it. You must also keep a list of people who are designated as written consent of service of process for all of your employees.

Next, we'll talk about the retention periods for these records. For all documents, you need to keep them for five years. This five years even applies after termination of the municipal advisor. So if you were miss -- a municipal advisor for two years, you need to continue to keep those records on hand for another three years to meet the five year requirement. And you must notify the SEC in that situation where the documents will be preserved. Organizational records must be kept for three years after termination. Electronic storage of these records is permitted, though. We'll talk about some specific requirements pertaining to that later.

First, let's talk about the general requirements for all records. Again, they must be easily accessible and legible. This makes sense because remember these records are required for a reason. We expect you to be using these to conduct your business one, and two, most relevant to this panel, these are the records you're going to have to look at in order to do a proper job of supervision of what's going on in the firm.

This -- the next concept is, I think, a very important one, and this one is discussed -- it's mentioned in the statute, but it's discussed in much more detail in the CFR. So I'll jump to this site for that. But when the SEC or some other regulator asks you for these documents, they must be produced promptly. Well, that is not specifically defined in the statute, but if you look in the CFR at pages 399 to 400, footnote 1347, what this means, in most cases, those records must be produced immediately, you know, within a few hours. Or I'll say loosely, the next day. And I say that because it doesn't really say that even in the CFR, but here's what it says in terms like -- of the outside time period you could produce these documents. It specifically says, only in unusual circumstances would a municipal advisor be permitted to delay producing records for more than 24 hours.

Now, I can't tell you what an unusual circumstance would be but I can tell you a couple of things from experience that are not unusual circumstances. One, that it will be a large number of records. That's not unusual. Everyone -- many of the firms we deal with talk about producing a large number of records and, with the technology available, it is not considered an unusual circumstance.

Secondly, stating that the records are hard to collect will also not be considered an unusual circumstance. Why is that? Because, as I stated earlier, one of the general requirements for all records is that they're easily accessible. So, they cannot be easily accessible and hard to collect at the same time. And that goes beyond not complying with the recordkeeping requirements because, as I stated, these are the records we're expecting you to be using to do your supervision of your firm. So they have to be easily available to your supervisors before they're ever easily available to us.

Now, here's a few special requirements for electronic storage. First of all, there must be safeguards in place to prevent destruction and alteration. This is not -- this next thing is -- in terms of a safeguard is not in the statute, it's not on the CFR, it's just based on something that I've seen in my own experience with other records of this type and that's a

called using a worm standard, W-O-R-M. Read once, write many. It doesn't solve the access problem, but it helps keep the documents preserved from being altered when you kept -- when kept in an electronic form. You also, therefore, must limit access and authorization to the people who can get at these records in order to assure, again, to protect against their destruction and alteration.

Now let me -- before I go into the next section and if -- and whether or not I do, let me ask, are there any nonresident muni advisors in the audience? No? So we'll do this quickly, in case there's someone on the webcast, but there's special requirements for the non-resident muni advisors which are simply they must report their domestic address to the SEC where records will be kept or sign an undertaking to produce records domestically when requested.

That being the case, I'm going to turn this over right now to Larry Sandor, who can tell you more about the MSRB rules.

Larry Sandor: Thank you very much, Dan. Can everybody hear me okay? Great. And I wanted to talk a little bit about the new MSRB rule G-44, but we've heard some comments from municipal advisors that while there aren't any rules in effect yet, so what I have to comply with, what do I have to supervise? And I just wanted to make sure that we were clear on this.

The statute itself, as we talked about this morning, has a fiduciary duty or requirement for municipal advisors in providing advice to their municipal entity clients. But in addition to that, there's a statutory antifraud provision. And the MSRB has promulgated a number of rules. Some of them are very administrative. But of course, our registration rule, A-12, we talked about earlier; G-17, the fair dealing rule; and now G-44. So this is probably the most substantive rule that we've adopted, and I'm going to -- so I'm going to go into quite a bit of detail about the supervisor and compliance obligations under new rule G-44.

On October 23 of this year, the SEC approved the new rule, G-44, on supervisory and compliance obligations of municipal advisors. The SEC also approved amendments to the MSRB's books and records rules, rule G-8 and G-9, to require municipal advisors to preserve certain records. And this is corresponding to some of the record retention requirement that Dan just spoke about.

The rule changes become effective on April 23 of next year. So G-44 goes into effect on April 23 of next year with the exception of G-44D, which is the annual certification provision, and that becomes effective on April 23 of 2016. So let me be clear on this: It's important that municipal advisors start now -- start preparing now to comply with the new rule, which will be in effect in April of next year. And then we would expect that the certification, the first certification, would be completed by April 23 of 2016. So if you haven't started the preparation, if you haven't familiarized yourself with the rule, we'll walk through the elements of the rules so that you're grounded in it and can start preparing for April of next year.

We also have had questions about the format of our rules. And before I start talking about G-44, I should say that we recently underwent a review of our rules and decided that we would have rule text and then supplementary material that we would start incorporating, similar to other self-regulatory organizations. And so you'll notice in G-44 there is rule text and also supplementary material. Now you should treat that supplementary material as having the same weight as the rule text.

So a cornerstone of our regulatory framework is rule G-44 which is, as I said, establishes

supervisory and compliance obligations of municipal advisors when they're engaging in municipal advisory activities. The rule utilizes a primarily principles based approach to supervision and compliance so as to accommodate, really, the diversity of municipal advisors that are represented here today and throughout the country. So we recognize that municipal advisors are of many different sizes, from sole proprietors to very large firms. And this rule, as I'll talk about in more detail, is a principal-based rule that allows for the flexibility to supervise a firm of any size.

Rule G-44 really is intended to promote a robust compliance and a set of supervisory policies and procedures while providing that flexibility to accommodate different sizes and types of firms. Of course, effective supervision and compliance oversight are fundamental to preventing and detecting violations of the Federal Securities laws and MSRB Rules. So rule G-44 has several basic elements which I'll discuss in more detail, but I'll just list the elements and then we'll go through them one by one so that you're have a clear understanding of each one.

The first is that you have to have a supervisory system that's reasonably designed to achieve compliance with applicable laws, rules and regulations so, an overall supervisory system.

The next two are really components of that first requirement of having a supervisory system and that is that you have written supervisory procedures that are reasonably designed to achieve compliance with applicable laws and regulations. And you have to designate one or more principals to be responsible for supervising the municipal advisory activities of the municipal advisor.

Next, you have to compliance processes that are reasonably designed to achieve compliance with applicable laws and regulations. And at least an annual review of the compliance and supervisory policies and procedures. You are also are required to designate a chief compliance officer to administer the municipal advisors compliance program. I happened to notice from the attendee list that there were a number of CCOs that had signed up, how many of you in your current businesses are the chief compliance officer? So maybe a third to a half of the room. So you're obviously familiar with the regulatory scheme. Perhaps, as we know, there are a number of municipal advisors that are also registered as broker-dealers, and you're -- you fill that role for the broker-dealer, many that are registered as investment advisors, and you fill that role. And obviously, in creating this rule, we understood and borrowed from the regulatory scheme for investment advisors and broker-dealers.

And the last element is an annual written certification by the chief executive officer or equivalent that the municipal advisor has in place a process -- processes to establish, to maintain, review, test, and modify the written compliance and supervisory procedures that are reasonably designed to achieve compliance with the law.

So let's talk about each one of those elements and break them down. The first is an overall supervisory system. Municipal advisors have to establish the -- implement and maintain a system to supervise the municipal advisory activities of the firm. And the supervisory system must be reasonably designed to achieve compliance with those laws. It must include, as I said, there are two subsets, two elements of the system. One is written supervisory procedures, which we're going to talk a lot about. And two is the designation of one or more municipal advisor principals to supervise the municipal advisory activities of the firm.

The MSRB has stated that a municipal advisor with few associated persons, or even one if it's a sole proprietorship, can have a sufficient supervisory system. The rule permits one person to be designated as responsible for supervision and the written supervisory procedures may be tailored to the size of the municipal advisor. But, be clear that the final responsibility for proper supervision rests with the municipal advisor, itself.

So let's talk about the first subset of this system which is the WSPs, or Written Supervisory Procedures. Municipal advisors must establish and implement and maintain those written supervisory procedures that are reasonably designed to insure that the municipal advisory activities of the firm and its associated persons are in compliance with applicable securities laws, rules and regulations. Now, a question had been raised during the comment process as to whether or not those written supervisory procedures have been -- have to be separate. And what we said in response is that that the written supervise -- that there is flexibility in designing the supervisory system and the written supervisory procedures, but to the extent to that there distinctions between the municipal advisory rules established by the MSRB and others, that we would expect that there would be separate written supervisory procedures for the municipal advisor activities.

Also importantly, those written supervisory procedures, as Dan said, can't simply sit on the shelf, they must be promptly amended to reflect changes that occur in applicable laws and regulations. And also as changes occur in the municipal advisor supervisory systems. And also, this is important, those changes must be promptly communicated to all associated persons to whom they are relevant based on their individual activities and responsibilities in the firm.

I often say that written supervisory procedures are living, breathing documents. They shouldn't just sit on the shelf, they shouldn't have another firm's name on them [laughs], of course. And they should be reviewed frequently and updated frequently. So whether drafted in house or by a law firm or consultant, it's important that they be updated promptly to reflect changes in the firm's business or the law and promptly communicated to written personnel.

Also, those written supervisory procedures must take into consideration the firm's size, their structure, the nature and scope of the municipal advisory activities, of course. The number and location of offices, the disciplinary and legal history of the associated persons in the firm and the likelihood that those associated persons may be engaged in relevant outside business activities. And also consider any red flags such as indicators of irregularities or misconduct. So basically, you're going to tailor, as Dan said, those written supervisory procedures to the size business model and structure of the firm.

Where under applicable law an associated person may supervise his or her own activities, the written supervisor procedures must address the manner in which any absence of a separate supervisor, those written supervisory procedures are reasonably designed to achieve compliance with applicable law.

The next element is the designation of a municipal advisor principal. So the rule requires municipal advisors, as I said when I started, to designate one or more municipal advisor principals to be responsible for supervising the municipal advisory activities of the firm. We've been asked during the comment process if you can designate a firm -- a principal by title, or do you have to designate the particular name of that individual? And the answer is that there is flexibility as to how you document who is the written supervisory -- municipal advisory principal for a particular activity. We were also asked if it has to be in the written supervisory procedures if -- or if it can be in a separate document. And again, we said that

there's flexibility as to where you document who those principals are or that principal is.

However you do it, you must be clear as to who is responsible for that activity. Because firms have problems in other areas, in broker-dealers and other entities, where it has not been clear as to who has been designated as the principal for a particular activity. And you don't want finger pointing between different people saying, I wasn't responsible for that activity. So, make it clear and make sure it's documented however you do it. But there is flexibility in that regard.

So a municipal advisor principal, I haven't really talked a little bit about what that means. It's a specific designation. The MSRB is going to be filing shortly amendments to rule G-3 which will establish two professional qualifications classifications. One, a municipal advisor representative, and those are the individuals engaged in municipal advisory activities that you've identified on the Form MA-I and also a municipal advisor principal.

The rule amendment to rule G-3 that we are going to be filing with the SEC will require, if approved, that the -- any municipal advisor representative and principal must take and pass the municipal advisor representative qualification exam, which will be, as I mentioned in my opening comments, available next year. The amendments would provide for a one year grace period for those individuals, the reps and the principals that must take the exam, to take it and pass it. And also under the proposed amendments to rule G-3, each firm would be required to designate a municipal advisor principal to be responsible for the overall municipal advisory activities of the firm. So, I wanted you to be aware of what that principal designation meant and what would be required.

Under G -- rule G-44, just going back to G-44, municipal advisor principals, under the rule, must be vested with authority to supervise their areas of responsibility. And so -- and also under rule G-44, municipal advisor principals must have sufficient knowledge, experience and training to understand and effectively discharge their responsibilities. So this is very important. If you designate someone as a principal, I think it's pretty clear, but I want to state it clearly, that they have to understand the activity that they're supervising. If they've been designated to supervise advice regarding municipal derivatives, they should understand that area. Or, advice regarding the issuance of municipal bonds, they should understand that area. So it's important that the principal, if they've been designated to supervise an area, understand it. And they must also have the authority to implement the established written supervisory procedures and take any other action necessary to fulfill their responsibilities. In other words, they can't be supervisor in name only.

Rule G-44 makes clear that a person not designated as a principal, may be deemed to be a principal if under the facts and circumstances the person has the requisite degree of responsibility, ability or authority to effect the conduct of the employee whose behavior is at issue. So, in other words, based on the facts and circumstances you may be deemed the principal based on your responsibility, ability and authority to effect the conduct of the employee whose behavior is at issue, even if you're not specifically named in the written supervisory procedures or otherwise.

So, just to recap, you can't be a supervisor just in name only. You have to have the ability to discharge your responsibilities. And conversely, you may be a supervisor even if you're not named if you're actually conducting the supervisory activities.

Next, let's talk about the next element of the rule which is the compliance processes. Municipal advisors must implement processes to establish, maintain, review, test and modify written compliance policies and supervisory procedures. And municipal advisors

must conduct no less frequently than annually a review of the compliance and supervisory policies and procedures. So while the rule requires that the minimum of an annual review, municipal advisors should consider whether more frequent reviews are necessary to comply with rule G-44. So you must do it at least annually, but you may want to consider the need to do it more frequently than annually based on your obligations under G-44.

We were asked in the common process if the municipal advisor could conduct the municipal advisor review together with, for example, an investment advisor review for efficiency. And the rule does provide that flexibility to conduct those reviews together, if they make sense for your business. When reviewing the policies and procedures the municipal advisor should consider a number of things so we'll go through what you should consider in the review. Any compliance matters that arose since the prior review, any change in municipal advisory activities of the advisor or its affiliates, any changes in applicable rules that might suggest the need to revise the written compliance policies or supervisory procedures. So for example, if you've been involved in a merger or an acquisition engaging in new municipal advisory activities, perhaps you hired somebody to provide advice regarding the investment of bond proceeds, municipal financial products such as derivatives or other areas that you've not been in before. As so you should consider any changes in the nature of your business when you conduct your review.

In this regard, each municipal advisor as you know must designate a primary regulatory contact under rule A-12 and the MSRB communicates important regulatory information by email to such individuals. Rule A-12 requires you to keep that email addresses current so that the MSRB can communicate with the municipal advisor. We've seen instances where, when we've tried to communicate with some of the municipal advisors that are registered with us, that the email address for that primary regulatory contact has been deactivated and obviously that presents a problem because we communicate MSRB regulatory changes to the primary regulatory contact through that email address. And you need that information in order to consider any applicable changes to MSRB rules when you are updating your written supervisory procedures. So please remember to keep all of your contacts current. It's a requirement under A-12 that you do so, but in particular the primary regulatory contact is very important that you make sure if somebody leaves the firm or if you change email addresses that you keep that -- those email addresses up to date, on Form A-12 so that we can effectively communicate any changes with you.

Next, lets talk a little bit about designation of the CCO, as we have established many of you in the room, or chief compliance officers. Each municipal advisor must designate, under G-44, the CCO. And the CCO, as we pointed out in the rule, has a unique role as the primary advisor to the firm on its compliance policies and procedures and its overall compliance program. The CCO should be able to understand that municipal advisory activities that are the subject of the firm's compliance and supervisory policies and procedures, just as a principle, should be able to understand the areas under their responsibility. Based on experience and consultation with others, the CCO must be able to identify applicable rules, such as MSRB rules, and standards of conduct that pertain to the firm's municipal advisory activities. The CCO must be able to develop or advise others who develop those compliance and supervisory policies and procedures and be able to develop programs to test compliance with the firm's policies and procedures.

There should be regular and significant interaction between the CCO and senior management regarding the compliance program. How many of you who are CCOs regularly meet with -- either sit on an operating or management committee or regularly meet with the CCO of your firm? So seems like almost all of you that are CCOs have said that. This rule is flexible in that the CCO may be a principal of the firm or a non-employee of the firm.

So you can outsource the role but not the responsibility. So if a non-employee is designated as a CCO, the municipal advisor retains ultimate responsibility for its compliance obligations. The CCO in any of his or her direct reports have responsibility to perform the compliance functions described in the rule, however we are clear in the rule that it does not -- we're not limiting or discouraging the participation of other associated persons at the firm in the compliance program. And we also have said that the CCO, and this is in recognition, again, regarding the flexibility based on the size of the different firms, the CCO may hold other positions in the firm including senior management or supervisor principal so long as that person can discharge their responsibilities as the CCO. So what does that mean? It means in a sole proprietorship, one could be both the -- well could be the CEO, the CCO, and the supervisory principal of the firm.

Next lets talk about the annual certification. So MSRB rule G-44D, which is as I said goes into effect on April 23 of 2016, so you have to have the certification done by that date. Requires municipal advisors to have their CEO or equivalent officer annually certify in writing that the firm has in place processes to establish, maintain, review, test, and modify the written compliance policies and written supervisory procedures, that are reasonable designed to achieve compliance with applicable rules. The annual certification requirement should help ensure that municipal advisors have in place an effective compliance program. You know we've been asked during the comment process, is the certification really necessary, is it important? And obviously we believe it so, we -- you know the solemn nature of a regulatory certification should ensure that the CEO takes time to reflect on the compliance program, engage as many of you already do, in a meaningful dialogue with the CCO, and gain comfort that the municipal advisor has a process in place to review, update, test, and modify its compliance and supervisory policies and procedures. In other words, we expected there would be sufficient attention to the compliance program at the highest levels of management.

FINRA members that are also municipal advisors are required under a separate FINRA rule 3130 to enter into an annual certification which is substantially similar to the MSRB's certification requirement. And the execution -- so in light of the FINRA requirement, G-44D provides an exception from the annual certification requirement for municipal advisors that are subject to the FINRA certification rule.

Also we were clear that the execution of the certification, and any consultation rendered in connection with it, doesn't by itself establish business line responsibility. The managers, the principals, are responsible for supervising the business, so the certification itself doesn't necessarily establish business line responsibility. There is also an exemption for federally regulated banks, a bank or separately identifiable department or division of a bank that's engaged in municipal advisory activities if in the exercise of its fiduciary powers so long as it certifies annually that it's subject to federal supervisory compliance and books and records requirements that are substantially equivalent to rule G-44 and they're relevant books and requirement of our rule G-8.

Now let us talk -- and just, Dan, if we could for just a minute -- about the books and records rule. I'm just going to take them all very quickly because I don't want to run out of time, but rule G-8 requires municipal advisors to keep all the books and records that Dan mentioned under the SEC rules applicable to municipal advisors. Also a record of the written supervisory procedures, the designations of the persons who are responsible for supervision and who are designated as the CCO, the reviews of the written and compliance policies and written supervisory procedures, and the annual certification as to the compliance process, or the certification made by the federally regulated banks that I mentioned. The preservation period for the designations is six years after the end of their

period of designation, and then five years for the other records. So I sped through the books and records. I'm sorry. I want to make sure we're okay on time.

Dan Gregus: Larry, can I ask you a question before I move to Laura [unintelligible] might be interested in? I know since you mentioned that in this regulatory scheme, a person can be a CEO or a CCO and a supervisory principal all in the same person and, therefore, might end up supervising themselves in some way. And I think you said that was all right as long as there was a reasonable process in place. That seems unusual for a supervisor system, so can you talk about what would you think would be reasonable in that set up in terms of the process to be supervising yourself?

Larry Sandor: Sure. And we've gotten questions on this during the comment process about whether or not there had to be a supervisory system set up and written supervisory procedures and designation of the CCO for a sole proprietorship -- and of course, as I walked through my comments on the elements on the rule, I tried to make clear that the rule provides flexibility for firms of different sizes and provides flexibility whether the firm is a sole proprietorship and the individual is charged with its own supervisory -- his or her own supervisory obligations or in a firm where they may supervise their own activities as permitted by applicable law. But the rule does contemplate that one could, for example, supervise their own activities, and that could take many forms. It's really up to the firm to decide. So if it's a sole proprietorship, that individual may go back and take a look at their own procedures, may go back and took a look at their own processes, their own activities from time to time as a check on those activities, or they may retain an outside consultant to do that. We know that there are a number of firms that are small firms or sole proprietorships that have engaged outside consultants to assist, and the rule does provide flexibility for a small a firm to designate an outside consultant to serve as the CCO.

Dan Gregus: Thank you.

Laura Trotz: All right, can everybody hear me? All right, so I want to just talk a little bit about how FINRA examines for supervisory systems. So all FINRA members are required to have a supervisory system in place to provide the business activities they engage in that FINRA engages in, and that includes municipal advisor activities. And much like Dan and Larry had said, the procedures that are put together are -- they need to be reasonable designed to achieve compliance with the rules and regulations. So that means that most importantly that the procedures are tailored to the firm's business, and Dan's right, we do actually find quite a few firms that have procedures that still say insert firm name here. So it's really important that your system, the supervisory system that you have in place, is actually what is captured in those procedures. We do come across firms that have a good system in place, but it's not what's in their procedures. So those really do need to match. But what do those procedures look like? So what we would deem an adequate set of procedures would be it details the policy, it identifies who is responsible for supervising that area, how frequent they will be reviewing the area, and how they're going to evidence that review. So we look at all of that, and that goes to the record keeping requirements that Dan and Larry also talked about.

Procedures will also -- periodically, firms will go back through those procedures and make sure that they incorporate amendments to rules, new rules that come out, any interpretive guidance that might be applicable to the firm. That's all -- all that information is captured in the firm's procedure and part of that review process.

Firms should also have a process around how they get that information out to the associated persons of the firm. So they know what the procedures are and how to carry

those out. Just to back up to -- with the person who is responsible for carrying out the procedure, that person should be as Larry had mentioned, that person should be qualified and knowledgeable in the area that they are supervising. And that they, more importantly, have the authority to carry out those supervisory responsibilities.

So in every FINRA examination, we're going to look at a firm's supervisory system and their supervisory procedures, and were going to test it. We're going to look at the particular area and just ensure that firm is whatever their procedures say, and their systems say that they're carrying out on that. And that's it, that process is consistent.

Couple things that I think that firms should want to consider in putting together procedures for municipal advisor activities is take a look at your associated person's outside business activities and whether any of that business activities involves providing advice and kind of noting any potential conflicts of interest in that area. Take a look at ensuring that associated persons are trained and they're -- especially on the fiduciary duty and other aspects of the municipal advisor rule. Steps taken by the firm to meet its fiduciary obligations to municipal entities, for example, how the firm identify manages and identifies conflicts of interest, how the firm determines whether funds being invested by or for a municipal entity, are the proceeds of the issuance of the municipal security, how the firm determines whether or not advice or recommendation was given, and how does the firm ensure that if the official at the municipal entity is authorized to act on behalf of the entity. So just some things to consider when creating those procedures, and then obviously we'll be looking at firms incorporating MSRB rule G-44 into their procedures which will be effective like Larry said in April of Next year.

I just wanted to talk about a couple things that we've come across in our examinations, I would say for the most part what we see are firms that have a good system in place, but their procedures don't accurately reflect that system. So it's a matter of just updating the procedures so they're consistent. And in some cases procedures they don't have -- firms won't have procedures that cover particular areas but like I said they'll amend the procedures to incorporate that. But they're also some other situations we come across and these are good things just to think about when trying to figure out what we should be addressing in those procedures. So we were at a firm, and this particular firm was hired as an , underwriter, and in that role provided a scope of services documents to the issuer, and in reading through the scope of services document this is what it said. It said, research, review, and analyze the district's statistical, demographic, and financial data. Determine the financing needs of the district and prepare various strategies to best achieve essential funding. And it goes on to say, bond proceed management after bond closing within the same agreement. So just from that, while it is a financial -- I'm sorry -- the firm actually undertook these activities, it hadn't in this case, but had it undertaken the activities with the bond closing proceeds, then the firm could have been in violation of municipal advisor rules. So it's important to when you're going through and putting together your procedures that you identify potential for this so you can catch that.

Another firm had this in their financial advisory agreement. Says whereas the issuer and blank desire to establish relationship which is terminable as provided herein pursuant to which blank can place debt securities and or related indebtedness with institutional investors as an agent for issuer as well as provide advice pertaining to the structuring and issuance of the securities and other matters. So again, you know the firms would not be able to do -- all of the scope of the services without violating rules particularly in the judiciary duty. So it's just things to keep in mind when you're putting together those procedures.

Dan Gregus: All right, well, we have a couple of questions here. One recurring question

was that the representative and principal exams of municipal advisors seemed to -- somewhat similar to the FINRA licensing requirements. Was there any consideration about providing reciprocity to the people who have already gotten series 7, 24, 52, or 53 exams?

Larry Sandor: Yes, that's a good question, Dan. So, you know, the question was, "Was there any consideration given to reciprocity of grandfathering those who had passed another examination?" And the board gave that serious consideration and determined that because this is a new regime, regulatory regime, from municipal advisors, it was important that all municipal advisor representatives -- that is anyone who is engaging in municipal advisory activities -- take and pass the examination.

We also received similar questions from those who had been financial advisors for many years and asked for an exemption or a grandfathering based on their years of experience. But the board had decided not to allow any grandfathering whether based on the certification or based on years of experience. So the proposal, which, of course, as I mentioned, has not been approved yet -- it's going to be filed shortly with the SEC -- would not permit grandfathering based on certification like that Dan.

Dan Gregus: Thank you. And I noticed that you also both mentioned things about qualifications of the principals here and outsourcing. I will say that in our experience we have seen issues in this area particularly with outsourced principals in certain situations such as FINOP, so something to be careful with. And besides that, often times where it's friends and family that have been hired to be the CCOs, and they're the principals of the firm. Would you say that could also be a red flag in this area?

Larry Sandor: Well, from our perspective, we drafted the rule to provide flexibility for small firms to be able to use outside consultants as CCOs. So I don't believe it's a red flag that you simply decide to avail yourself of the flexibility of the rule and designate someone as the CCO who is not an employee of the firm. But I would caution you that it's important that whoever is designated, not be designated in name only. Just as I mentioned with the principal, that whoever is designated as the CCO actually have the time and the knowledge to take that responsibility seriously and carry out the functions that are required by rule G-44.

Dan Gregus: And I think for both of you, is there a minimum supervisor to municipal advisor ratio that your exam team would look for when testing the compliance rule with G-44.

Laura Trotz: I think for FINRA, we would just look at the size, the organizational structure, how many branch offices, how many reps, and determine the system that's put together and whether that appears reasonable based on the business activities of the firm.

Larry Sandor: And of course, we're not conducting the examination but under the MSRB rule, the system has to be reasonably designed to achieve compliance with applicable laws and regulation. So we would expect that they would have a sufficient number of principals appointed to be able to supervise the various areas of the business, and that those principals will have sufficient expertise, knowledge, and training to be able to carry out those functions.

Dan Gregus: I have to agree with that. We would not have the minimum ratio. We're going to look to those factors that were mentioned, as well as other things that we've seen. Like you want to determine -- we'd rather not seen a principal that's remote from the MA's, sufficient geographic closeness to be effective. And determine how much business each

particular MA's is doing and whether it's all in the same offices or in different offices across a particular region.

Now another question we have was, with respect to third party solicitors, and how do -- what's your opinion of where they fall within this supervisory procedure realm?

Larry Sandor: So the MSRB rule G-44 doesn't draw distinction between different types of municipal advisors, if one is designated as a municipal advisor-

Female Speaker: 12-6-0-8-3-9-6

Larry Sandor: That's okay. I think that's almost our cue that our time is about up, but we'll go ahead and finish up this question, and then they can turn to the next panel. So the MSRB rule G-44 does not draw a distinction between solicitors or other types of municipal advisors, so each type of municipal advisor must comply with G-44 and have that system of supervision in place that is reasonably designed to achieve compliance with the law and be tailored to the nature of their firm. So you'd expect it to be tailored to the nature of their business. Thanks Dan.

Dan Gregus: Laura, have anything to add to that?

Laura Trotz: No, I would echo exactly what Larry said.

Dan Gregus: So what about the situation where you have a computer system? And this is asking about adequate collection and maintenance of records. I feel like a computer system that automatically backs up your emails and documents continuously and the staffs are instructed to identify all municipal advisory work with a code such that searching the code will generate all relevant documents. Is that something that is a step towards or is sufficient record retention in your mind?

Laura Trotz: I think that it meets the requirements of the rule from what you've explained. The fact that they're able to identify specifically for municipal advisor records will probably help with gathering the documentation if it's requested during an examination more efficiently.

Dan Gregus: Sure. I think they're --

Larry Sandor: The MSRB rule does stand of course contemplate that records could be stored in electronic storage medium.

Dan Gregus: It seems like there would have to be some testing though that was done periodically that makes sure the employees were coding the documents correctly so that they did pull up the documents sufficiently, and/or that the system and the software that we're using with pulling up the documents that were properly coded. Otherwise such a system could turn out to be ineffective and then therefore your procedures wouldn't be reasonable if you were relying solely on this. There always has to be some type of backup testing to ensure that it's working the way it should have been.

Laura Trotz: Yeah, I would agree on that. You want to make sure that if we're asking for specific records that we get the entire request and not miss any.

Dan Gregus: Here's another question that came in: Rule G-44D proposes an annual certification requirement as -- so the firm's compliance procedures. This seems very similar, again, to FINRA's annual certification rule for broker-dealers. Will firms have to comply with

both requirements?

Larry SandorAs I mentioned in my comments, if a firm is obligated to comply with FINRA's annual certification requirement, they can comply with that requirement in lieu of the MSRB requirement. So if you're subject to FINRA's annual certification requirement, there is an exception -- or an exemption for you.

Dan Gregus: Great. And then, finally, is there -- we've talked about the differences and the flexibility of the rules. Is there any type of exemption from the supervisory rules, or are there modified supervisory standards for single person or small municipal advisors?

Larry Sandor So we did get that request during the comment process, requests that small firms or small proprietorships be exempted from the supervisory rules. Along the same lines of the question you asked earlier about whether an individual can supervise him or herself, and the MSRB has determined that the rule provides for the flexibility for supervisory system for any size firm. So there is no exemption or exclusion for small firms or self-proprietorships. All size firms must comply with G-44.

Dan Gregus: All right, thank you. And thank you for your attention. The next panel will be at 2:45 p.m., so we're going to have a short break here. And I'll be here for the rest of the afternoon.

[applause]

Robert Miller: Good afternoon, everyone. We're about to begin our last panel, which is called the examination process. I am Robert Miller; I'm a supervisor attorney with the commission's OC office in Washington, D.C. Next to me is Steve Vilim. Steve is an examination manager in our Chicago regional office. Next to Steve is Cindy Frelander. Cindy is the director of the Fixed Income Regulation and Operations Group at FINRA. And next to Cindy is Shawn O'Neill. Shawn is associate district director in the Chicago district office of FINRA.

As I said, our examination panel will discuss the examination process, but before we get into the details of the examination process. I wanted to just tell a little quick story. A couple weeks ago my assistant director and I were out in Portland, Oregon. I think I see some of you from that conference and we got really good questions about what to expect for when the SEC comes on what they should be prepared for, but one of the kind of weird things we got was folks seem to be very intimidated by the SEC, by the examination group. And that's something that we normally don't get, so I think I was quoted in a bond buyer saying that "We don't come in guns-a-blazing." I think I'll put that on my tombstone one day.

[laughter]

But I did want to, as part of going over, just to let folks know what they can expect from examinations staff at the commission as well as examination staff from FINRA. But before we get into the details of that, I wanted to circle back to something that Drew mentioned earlier. He mentioned the role of OC and the commission, at one point he mentioned that we conduct exams, he also mentioned that we have outreach programs. In addition to what Drew mentioned earlier, there's something that OC and SEC is starting now. It's called an MA examination initiative. And that examination initiative has three parts. The first part which is actual what we're into today is the engagement phase and that's the part where we reach out to restaurants such as yourself and I think in the case with MA's, we put

something on the SEC's website announcing who the SEC is, who the OC is, what to expect when you're coming to an exam. The next part is examination phase and Steve will go into a little more detail that will give an overview of the day to day exam process and what it should like. In respect to MA's, I just want to let folks know that some of the areas that we may be covering as part of our overview will be obviously MA registration MA compliance with fiduciary duty, disclosure, fair dealing, supervision, books and records, employee training, and employee qualifications. I think some of these topics, or most all, we've touched on today but I want to put focus on notice again that these are just some of the areas we'll be coming to look at, there may be others depending on any additional rules and regs put out by the commission MSRB or FINRA. The last part examination in this view will be in foreign policy. And that might be in a form of taking what information we get in exams and letting the commission know what's going on, or the possibility of putting out a paper or report identifying some of the issues we've come across and conduct in exams. So that's kind of an overview what to expect an examination initiative. I turn it over to my colleague Steve Vilim to give a little more detail in the exam process. Steve.

Steve Vilim: Thank you, Robert. Hopefully everyone can hear me. My name is Steve Vilim, I'm an exam manager here in the Chicago region. I just want to thank you for giving me the opportunity to speak to you today about what are the typical exam process that the SEC will conduct for a municipal advisor only. I have the duty to explain to you in about ten minutes what our exams sometimes cover over weeks or several months, so I'll do my best. I tried actually doing this with my son, he is only six year old. And after I got done he said Dad are they going to be in trouble? And I said hopefully no trouble, no trouble.

Let's get into the different stages of a typical SEC examination. There's four. There's the pre-exam, the fieldwork, post-fieldwork, and the closing stage. And let's walk through the first stage. It's actually the pre-exam. Here, our staff is going to obviously going to want to learn a little more about you as a firm, now obviously we have our own databases but we're going to be reaching out to you to get a little bit more of a high level about your business and how are the operations. For example, we're going to really want to know about what your target markets are, possibly looking at your top revenue firms that you're dealing with and maybe count any source of referrals of how you keep your business. Obviously, your supervisors structure, which I think the other panels have discussed pretty thoroughly, for us who are going to want to know how that's operating as well. So these are just some of the initial things we are going to want in our opening calls to you guys. But at the same time, too, we're going to be sending to you one of our initial document request letters and some of the information we're going to want to get that in advance before we come to visit your firm, and this, typically, is given to you a couple weeks in advance before we show up so there won't be any surprises. And we do anticipate getting all those items on the first day of arrival when we come to your firm. And at the same time, too, when we reach out to you, some people may pause it or some people will say, "Well, how do I know I'm dealing with the SEC?" Obviously, you can exchange emails with the person you're dealing with, or you can actually look at the SEC's website, and each of the regions has the main number, so you can call into them, and they can patch you to the actual examiners just in case.

Some of you may ask yourself, "Well, how big are these teams coming out?" You know, each team is made up -- the whole team is not coming out, but the team structure for each of these exams will consist of a assistant regional director; an exam manager, such as myself; a team leader; and possibly one or two staff members; and then we have an attorney advisor. So we have a full house to watch you guys. But as far as individuals actually coming out to conduct the exam, it typically will be an exam manager, a team leader, and possibly one or two staff members. Again, it depends on the size of your firm

and also depends on the scope of what we're looking for. And again, those are some of the items that you hope you gauge on how big an air reach you may need for us. But at the same time too we send our initial request letter out, you're also going to get -- the firm's going to receive form 1662 I'm sorry, 1661 that actually lists out -- it's called title supplementary information other than a subpoena, but it walks through, basically, six areas of what the rights are as for us as the SEC examining and what your rights are.

Let me just walk through these really fast. It discusses our authority for requesting documentation, it talks about the effects of not supplying the requested documentation or refusal to allow inspection, reminds your firms of the penalties providing false statements and documents, it describes the commissions principle uses of this information, it lists those routine uses which includes making files available to any United States attorneys or state prosecutors, and also then the south of freedom information act in case your firm wants to send to us written acknowledgement before we give documentation over you have a first chance to take a look at it. So that is the Form 1661. That information is available on the SEC's website so you can download that and take a look at that before you actually get it.

So once we get all that information, the initial information before we get to your firm, we're obviously in the second stage is going to kick in and that is our fieldwork. This exam stage typically takes about a week, could be shorter could be longer again depends on the size of your firm and what we're looking for or looking at. So you can imagine when we show up we're going to definitely request another opening interview with your firm to again go over any remaining business items that we didn't discuss on the first call, we're going to want to walk through the remaining request items, make sure we have everything. At the same time too get that acknowledgement of that form 1661 that's signed by your firm.

During the fieldwork I think it's -- we cover pretty heavily we're going to be focusing on seven core areas and Robert, you just mentioned them. But I think -- let me back pedal here, about I think I may have skipped over what the request letter from the items maybe asked for. There's initially -- I mean again this is a typical type of exam there could be up to say for example, 20 items that we're requesting and it's broken out into three areas. I'm not going to go through each of the individual items, but I can walk through at least some of the section areas so you can see what we're looking for.

So for example on the general information, again we're going to look for all agreements and contracts between your firm and any affiliates that you have. We're going to be looking for a copy for any of the minutes that your firm's management committee has, a list of all services provided by your first and possibly copies of all contracts and agreements, a description of any referral fees and consulting fees arraignments that you may have, a list of any and all complaints, litigations, arbitration involving your firm. And then when it comes to the financial records we're going to be looking for the balance sheet, income statement, trial balance, adjusted trial balance, and adjusted entries. Am I going to fast? Yeah okay, I'll slow down. It's a lot of coffee.

Robert Miller: Steve, I think, as you mentioned, this is not an exhaustive list, so you're just giving --

Steve Vilim: Oh, yeah. And I apologize; I do speak a little fast. And also, too, as a general ledger, cash receipts, and disbursements journal, bank statements, account recs of all those firms, the bank accounts.

And now we get into the last section of the municipal business. Obviously, this is your core business. We want, again, a list, a description of all the municipalities to which your firm

rendered services, including any amounts or fees received, and then a description of the types of services provided. So obviously, this would cover, if you're dealing -- for example, advising on offerings and also you're transaction based, we're going to want to get a list of all of your marketing materials, literature, and advertisements used by the firm; copy of any documents that was material to making a recommendation to a municipal entity; and for samples, the deals that you were acting as a financial advisor for a municipal offering; and copies of the final transcripts and all electronic communication records of the lead advisor. And then, obviously, definitely copy of your written supervisory procedures; compliance procedures; your ethics policies; and then, finally, the firm's training schedules and supporting documentations that were provided to the registered advisors.

Okay. As I mentioned, we're going to be going over the seven areas that was already previously discussed. Obviously, you know, once we get the documentation from the original request list and we start going through the actual support, it's expected that we're going to have additional questions and follow up for your firm. So at that point, we're going to most likely want to interview some of the financial advisors that are providing the advice. At this point, at this time, we're going to also provide to those individuals a form, our form 16-62. It's similar to the form 16-61 except it's just targeted towards the individual. And prior to our interview with that individual, he's going to have to read it and acknowledge that he's read it and give us a copy of it back with his signature.

And for the moment here -- I know I have just a couple minutes to speak, but I want to go over some of those seven areas of our core that Robert initially mentioned and maybe just focus on a couple of the items and give you a direction of some of the things we may be looking for when we're out there in the field. Obviously for registration we want to make sure your firm is registered appropriately, and once the rules are finalized on the actual licensing of the advisors and make sure they are adequately and properly licensed and passed their tests.

For the fiduciary duty -- I know we've had a whole panel on it and discussed pretty heavily about what's right and what's wrong. You know, an additional item that we obviously are going to be focusing on is again the services that you're providing to your municipal entities. We want to make sure that whatever you agree to comply with, that you're actually going to follow up and do it in the best manner, in the best interest of the client. So if you're recommending those complex structures and numerous municipal offerings does it make sense for the issuer? And again too, when we look at what you tell us what the services are that you're providing to the municipal issuer, for example, is your duty to look over the official statement, are you the ones out there and getting the data and putting it in there? If so, we're going to look for that. Are you the one running the numbers behind that actual modeling for the underwriting? If you are, we're going to look for that. And again we just want to make sure that you're doing this in the best interest of the client and making sure that it is reasonable, fair, and it's not going to contain any material misstatements.

The other item that we want to focus on too is obviously fair dealing. We had a whole other panel talk about the practices that we see here in Chicago, but that deals with unethical play to pay type of practices. But in this issue too we are also going to look for any kind of, I think it was referred to before, again is undisclosed conflicts of interest. You know, looking at whether the financial advisor actual has invested interest in the project being underwritten for that issuer. And then lastly, the suitability of the transactions, again looking at what kind of transaction based recommendations you're giving to the assurers, who are obviously going to have to take a look at that as well.

Supervision, I think, was handled pretty well. Obviously, we will be looking at your controls

you put in place over the reps and make sure it's reasonable. One of the things, you know, obviously is a trip up or you can definitely tell if your supervisor process is not up to snuff is if you start having weaknesses or deficiencies if you find them yourselves. Or if definitely if examiners come in-- If we start finding problems in different areas. Obviously it's a red flag for your supervision process as well. They kind of go hand in hand. Books and records, again, it's been covered in when you get the request letter. It's the same information we are going to be wanting to get from your firm.

And then, finally, it's the training qualifications of your reps. Obviously, you want to see if the firm is taking this seriously and providing adequate training to them and how often. So then this is -- again, this is all happening in the first week we are out in the field, and if, for some reason, we decide that's enough for the fieldwork and we go back, before we leave, we will give your firm a preliminary exit interview. It's just a walkthrough, and if we do have potential items we want to raise to your attention, we'll bring it to you at that time. If not, we'll make sure we get a wrap-up of open items, the list we requested.

And we go back and enter into our third phase, which is a post-fieldwork stage. Here, this could take -- unfortunately, it depends on how much we're looking at and the nature of the business or your firm. It could take several weeks to, possibly, several months. So I would imagine -- you could imagine initial follow-up requests from the staff and also possibly more interviews with some of the advisors. And then once after all that is done and the staff feels comfortable with its analysis we enter into our fourth stage which is I call the closing stage. So there's two things that could happen possibly in your closing stage. You may get the call-- Well definitely going to get a call to say here's your final exit. And two things can happen. You can then get a what is considered a no comment letter. So here, this letter just basically says we conducted an exam of your firm and it's closed. The other thing that could happen is obviously if the staff determines that there's items that warrant your attention. This is deficiency in so the rules and regulations. We will then list them out to you and let you know. Then after that you have about -- you definitely have 30 calendar days to respond once you get a letter from us. And in that response to us you can have the option to agree or disagree. Obviously we love if you agree with all our findings. If you choose to disagree, that's your right. And just to let you know though when you disagree we have to be staff have to take a look at your response letter and determine if whether or not what you're saying makes sense. Maybe we possibly missed something. But if not, you'd anticipate a letter follow-up back to you letting you know our position. And typically, it would usually stop at that point, but I've seen letters go back and forth a couple of times.

So just wanted to let you know the whole reporting process and timeframe for those four stages. And in addition to -- it's one thing I wanted to at least point out, too, as we talk about, the process of conducting exams and dealing with you as advisors on a professional level, you know, if you ever come across any kind of -- you think is kind of corrupt municipal advisors, you know, we do have an office [unintelligible]. So I do encourage you anyone that you want to tip, complaint, or referral. We do have an office that would handle that and accept that, and that's on our SEC's website. So with that, I think I could turn it over, then, to Cindy. What an examiner would do on a media examination.

Cindy Friedlander: Okay, thanks, Steve. Today's program has been a really great way for FINRA, the SEC, and the MSRB to demonstrate publicly what has been really been taking place behind the scenes for quite some time with respect to how we're collaborating and cooperating on the municipal advisory exam process. We've been meeting monthly to discuss areas of mutual concern. And earlier today, Ed Wagner talked a little bit about our risk space exam process and the transparency that we've tried to impart into, you know, what you lost with respect to exams.

So I thought I would elaborate on some of those points. Ed did mention that FINRA employs a risk based exam process. Most of FINRA's front-line regulatory operations takes place within two departments at FINRA. The member regulation department which has 15 district offices across the country and our market regulation department which conducts a more centralized surveillance of the market in a couple of locations. In some matters, there are areas of common concern between those two departments such as trading, mark-ups, that kind of thing. Municipal advisor won't be one of those areas. Member regulation will be primarily responsible for examining FINRA members that are municipal advisors. Member regulation examines all 4100 FINRA members on a four year cycle. And that cycle is based on perceived risks at those member firms. So what does that mean? Risk is a word that gets used a lot. So I think I'll break it down for you in very high level terms. First we kind of take a look at the firm in terms of quantitative analysis. Revenue, number of reps, number of branch offices, OSJs, that kind of thing. We look at that in terms of the firm's impact on the market. So you can probably name off the top of your head the ten most impactful firms in the securities market. And those are the firms that we're going to be examining most frequently, as frequently as annually.

Other firms might be on a two, three, or four year cycle depending on our risk based analysis. We also look at more qualitative factors such as things like what types of business a firm is engaged in, the number of customer complaints a firm has received, disciplinary history, a culture of compliance. The examiners that go into the firm all the time and talk to the firm kind of know what's going on at that firm. We have regulatory coordinators that are constantly monitoring what's happening at that firm. So a firm's exam cycle may be shortened or lengthened based on these qualitative factors at each firm. Then every year we conduct a risk analysis of each firm and we actually have a qualitative and quantitative analysis that occurs during every -- latter half of every year to develop the exam cycle for the following year. That process is currently underway, and municipal advisor activity will definitely be one of the things that we'll be looking at.

Certain types of risks are identified as standard priorities each year and we do communicate those risks to each firm through an annual priorities letter that we send every firm as early as possible in the year. Usually early January. We also post that on the website so it's publicly avail so members of the public can see what we're looking at that year. And it really does change from year to year, reflects the dynamic nature of the securities market that helps us allocate our resources according to the risks that we've identified and it does influence the-- So what examiners are going to focus on at a particular firm if priorities have been identified and the firm is involved in those priorities, we will most likely be taking a look at those things when we come on site. Municipal advisor was identified as a priority for 2014 and it likely will be identified as a priority for 2015.

We also work very closely with the MSRB to identify exam priorities not only for municipal advisors but municipal securities broker-dealers as well. We've already begun examining municipal advisors so during 2014 we reviewed the dually registered municipal advisor broker-dealers that were already scheduled for municipal securities exams during the latter half of 2014. After the rule became effective on July 1st. For 2015 we will not be looking at every single municipal advisor that's been registered, but we will take into consideration the level of activity at each municipal advisor. Final registration data is not quite yet available. We're using other outside sources of data to identify municipal advisors and the level of their activity. We'll also be looking for potential unregistered municipal advisor activity and maybe this is some comfort to those of you in the room you are really trying to comply with the rules and learn as much as possible as much as you can about this area and apply the rules correctly. Because FINRA members are all brokers we think that there is great

potential for firms that have municipal entity clients. They may not realize that making a recommendation in terms of transaction to one of those clients may make them a municipal advisor, so we have conducted mandatory training for every municipal-- For every member regulation examiner this year to sensitive them to that fact. That any firm they walk into regardless of whether that firm is registered as a municipal advisor may be engaging in municipal advisor activity. Other firms may have made a conscious decision to avail themselves of one of the exemptions or exclusions that are available in the statute and the rule we want to be looking at whether the firm is applying those exclusions and the exemptions appropriately. We've also developed municipal advisor specific exam procedures, questionnaires that examiners can use. We do business activity reviews with every firm that we're going into. So we have a basic set of questions to ask, to kind of drill down, to see if whether a firm is engaged in municipal advisory activity. In certain regions of the country where there are high concentrations of municipal advisors we might a specialized exam team going in, particularly in New York, so that those exams are so very well versed in municipal advisory activity and be able to talk to your friends about it in depth.

To ensure consistency between FINRA and SEC plans we are meeting on a monthly basis. We have a working group that kind of goes over issues that are really coming up on some of the center exams. Answered questions get interpretations from the office of municipal securities and MSRB staff. And as MSRB continues to develop its new rules, we get a really good understand of what is required by those rules and how to apply them. So I think at this point I will turn it over to Shawn to talk to you a little bit more about specifics of a center exam and what you can expect.

Shawn O'Neill: Thanks, Cindy. When she talked, she primarily talked about examinations that were being conducted on behalf of municipal advisor firm non broker-dealer, non FINRA members. So my comments really are going to rest primarily-- Exclusively, I should say, on those broker-dealers that are members of FINRA. And I am curious if I could just have a show of hands how many FINRA members do we have here in the audience right now. All right, and of those people that raised their hand. How many have been examined in the past, let's say, 12 months? Quite a few. So the reason I asked that was we've certainly at FINRA changed the way we conduct examinations, and I think those of you who raised your hands, you've seen the way, or at least the changes that we've implemented with respect to the examinations. So most of our-- Actually all of our examinations done in the cycle space where we show up on site are now done electronically. Gone are the days where we send requests out and say we'll be there in two weeks, give us documents and we show up and there's boxes and banker's boxes and reams of paper all over place.

So now what we do is we announce the exam roughly 60 days prior to us going on site and from that moment when we announce the exam, going forward we'll make requests, have conversations, and we start getting the records electronically. So instead of showing up to your firm, let's say, November 1st and starting the exam, the exam is pretty much started now, well in advance of the day that we actually show up on site. And the reasons are many, but I think primarily what we want to do is we want to make sure we're appropriately risk scoping the examinations and by getting the documents early, by getting conversations with the firm, I think that's assuring we're having those meaningful conversations and scoping the exams appropriately. There's similarities in terms of how we conduct exams versus how Steve indicated the SEC does exams for the MA firms. Some differences that I'll elaborate on as well. One is that for those FINRA members in this room, each of you has an assigned coordinator, a regulatory coordinator, and he or she is responsible for know your firm, being your primary contact with FINRA. Well, and similarly also providing our staff with the surveillance and information that they need in order to conduct the exams. So

what that means is, our coordinators play an integral part in the examination process. Primarily that process leading up to the part where we go on site, right? What they do is, they will have ongoing conversation and dialog with your firm, even if we may not be going on site to conduct the exam. So let's say for example, you're not on our docket for the year, but the coordinator is having ongoing conversations with your firm regarding your municipal advisor business. On the other hand, if we are going to your firm they are also going to have those conversations.

Some of the questions that they're going to ask: They'll want to know what types of muni advisor business activities have you engaged in. Are you engaged in the type of activity that FINRA described where you're making investment recommendations with respect to proceeds from a bond offering. Are you advising state and local government regarding public finance alternatives. Or are you assisting state and local governments with respect to evaluating other advisors. So questions like that help us specifically target our risk reviews that we want to focus on. They also-- Our coordinators are also going to want to know what your role is as an advisor. Are you a financial advisor, are you a third party marketer, are you a solicitor, are you a placement agent, are you a finder, are you a [unintelligible] advisor? And again, all of the answers we get to those questions will help us tailor and focus how we conduct reviews. We're going to want to determine how the firm attained MA business. Was it done through a negotiation process, was it done through a bidding process, was it done through a referral program, was it done through, perhaps, a recommendation made by an affiliate of the advisor? Our coordinators are going to ask and want to know about how the firm is compensated with respect to this MA business. We'll also want to know to the extent your firm is supplying any exclusions or exemptions from the MA. We want to know the basis for that as well.

Laura's panel that preceded this one talked a lot about supervision, and one of the reviews that we will conduct with respect to the FINRA space is Cindy touched on this in her comments about us being really risk based. And in that regard in order to be risk based what we need to do is we need to get a really solid understanding of firm systems and controls. So we may not necessarily dive beyond systems and controls, in other words we may not test everything in every single case but what we really want to do is get an understanding of how the firm supervises and what processes you have in place to monitor and effectively regulate this MA space.

And I think the first place we start and I think you've heard this several times today is with the firm procedures. And I'm not going to regurgitate what's been said before but suffice to say we're going to look at the procedures, we're going to make sure they're adequate and that they address the current rules and regulations. I think the preliminary right now I think the findings that we're seeing, perhaps more so than anything made me deal with procedural deficiencies and firms that need to beef up certain procedures. The other thing we want to see is certainly is the firm identified any designated supervisors for this business. Important to us to make sure that this is being appropriately supervised. We also want to make sure that the firm is conducting an annual review of the business. Certainly under FINRA rules, but since we're dealing with municipal activity under MSRB rule G-27, the firm is required to conduct annual reviews of the business under G-27D, I believe it is. So to the extent the firm is engaged in this business, we want to make sure that they're conducting an, or will be conducting annual review of this business space.

We also want to make sure that they're including or will include the part of their annual compliance meeting. Again to the extent your firm engages in this business as a FINRA member, we want to make sure this is included in your annual compliance meeting and also as important is training and on going training for your reps and employees that engage in

this business. It's a key component to our reviews and we want to make sure that the FINRA members are appropriately training and providing ongoing training for it's associated person. Laura also touched briefly upon the concept of outside business and it's interesting because what I am reading from you right now is it's kind of a key to a sneak peek if you will at what our examiners do so what I am sharing with you quite frankly is the review that our examiners actually do are considerable in respect to exams. And two of the things that we will consider in this space for systems and controls is whether or not your firm has employees or associate persons that are employed or affiliated with an external MA, an external municipal advisor. So not necessarily one that's a broker-dealer but one away from the broker-dealer.

So the question we would want to know with how is the firm reviewing this activity, specifically from two components. One is how are they monitoring and ensuring that there may be any recommendations being made by this employee to this outside MA. And then also review any potential conflicts that may exist as a result of his or her relationship with that outside MA. The other outside business concern and -- maybe not concern but option that firms should be aware of is to the extent an employee or associated person is involved with a municipal entity, like a local school board. And so we would consider that to be an outside business to some extent. And then, again, how is the firm reviewing that activity and then show, again, that that employee isn't making recommendations or, if they're making recommendations, how are they appropriately supervising that and, again, considering any potential conflicts that may exist in their role on that school board with any potential recommendations that are being made.

Before I forget, also, what I want to do is just kind of look Cindy in real quick here and just kind of give you the dynamic and relationship between Cindy and the district offices. So I do work for the Chicago district office, I've been there for almost 17 years, started out as an examiner. And Cindy has a really good -- and Bonnie, too. Both of them have a really great working relationship with the districts and they're a really integral part to our examination program. And to the extent we run across any unusual or maybe some situations that maybe we don't have the expertise in or we haven't seen before, we routinely pick up the phone, call Cindy and Bonnie. I don't know if -- do I call you more than anybody?

[laughter]

Robert Miller: That's probably right.

Cindy Friedlander: You're high on the list.

Shawn O'Neill: I'm high on the list. I'm high-maintenance, right? So -- but the point is I think we have a really great relationship, and I think even to the extent that we run across things that might need for the vetting, Cindy will reach out to MSRB or other folks as well to kind of get some expertise and opinion on that.

The other thing that we talk about is investment proceeds, and I think I've heard this at least three or four times today, and certainly Cindy mentioned this as well, and I suspect that -- I guess, you know, it's an incorrect assumption I had before learning more about the municipal advisory space that I initially thought that this would only apply to firms that are engaged in the public finance business. But lo and behold, there's this concept in there of a broker dealer can be subject to the MA's rules if they are making recommendations to municipal entities with respect to bond proceeds. So that doesn't mean -- this could be firms that never, ever engage in underwriting, that never ever engage in any public finance activities, but they've got these customers that they're making these recommendations to, and they may or may not know the source of funds. So this is something that our

examiners, like Cindy said, have been trained to look for, that we will be looking for. So certainly we're not really considering firms that are registered or need to be registered in the advisory space, also though that aren't registered [unintelligible] on this activity, they need to be registered.

Conflicts of interest: I think Steve talked a little bit about that. I think previous panels talked about that. So we certainly are considering the conflicts of interest in our reviews when we conduct examinations. In terms of the actual reviews that we conduct while we're on site, I think the first place we start with as examiners is we review the engagement letters. And what we're looking for is we're looking for compensation in these engagement letters, we want to understand how the firm is being compensated, how the reps are also being compensated, and how are fees being set for the type of business? We're looking for disclosures being made by the municipal adviser to the municipal entity. We want to make sure that the conflicts of interest are being appropriately disclosed. We want to make sure that compensation and the scope of engagement is complete and adequate. We're looking to make sure that disclosures are being made timely, early in the process, not later in the process. We want to make sure that firms receive written acknowledgement so that the broker dealers are receiving actual written acknowledgement from the municipal entity that they received a disclosure. And we also want to make sure that the broker dealer has a fundamental understanding and done some due diligence to make sure that the municipal entity actually understands what it is that they're attesting to and signing off on. I think we talked earlier this morning about suitability, so to the extent that we have a broker dealer making recommendations to a municipal entity with bond proceeds, we certainly are looking at that recommendation for suitability. We're also making sure that the person that's acting on behalf of the municipal entity has the requisite authority to make those decisions. We also want to make sure that firms aren't tripping up in their role as an adviser, so they're taking into consideration -- I think Laura talked about this in a couple of scenarios that she mentioned, one of them was a case that my team worked on. But we want to make sure that to the extent they're engaged as a municipal adviser, they're not also simultaneously engaging in underwriting activities with that same issue -- or regarding that same issue with securities. We've seen some firms that have come close to violating -- at least I have -- that come close to violating that, but I have not -- I think maybe you've seen a few that have come into that space of problems.

In terms of books and records, I think Steve talked about some of the books and records, interestingly. For those that are only municipal advisers, non-broker dealers in this room, we will ask our broker dealers for almost the exact same records as we ask the non-broker dealer firms for, so we're going to be asking for correspondence, most likely we'll be looking at email. We're going to be asking for the firm to check books, bank statements, general ledger, we're going to ask for procedures and all copies and all versions of the firm's procedures. We're going to ask for any agreements they've had with municipal entities. We're going to ask for a list of municipalities that they've engaged in this business, or plan on engaging. We're going to be asking for training materials. So, again, very similar records that Steve and his team are asking for. In terms of, you know, I think the folks here that are broker dealers have a fairly good understanding of what to expect in our exams, but let me just kind of go over that real quickly. So, unlike Steve's group where it sounds like they send an attorney adviser, maybe an associate director and manager and staff, in our exams, we primarily will send an exam manager, someone to report to me and then examiners that report to that exam manager. The size of the team can be anywhere from one person to six, sometimes maybe more than six, but very rarely more than six. And the amount of time on site presumably should be less now that we're conducting our reviews through this workspace and now that we're conducting a lot of our reviews in our office before we come on site. So, the process is much like the process Steve described, and that

is we show up on site, again, presuming we've done a lot of the work in the office, what we're going to do is follow up with the appropriate firm personnel, ask some questions if we have follow-up questions, finish the review, then conduct an exit conference with the firm. And then once the exit conference is done, we work diligently to make sure that we get our final exam report out to the firm which identifies any issues. Or if there are no issues, then a statement to the firm within 60 days of the exit. If we can't get the exam report out to you within 60 days, the manager or me will call the firm and kind of give you a status check of where we're at in that process and when you can kind of expect that exam report. So that's really kind of at a very high level discussion centered on what we do with the firm's municipal advisory space.

Cindy Friedlander: And if I could, I'd just like to follow up on the point that Sean made about reaching out to me and my team. We're a central point of contact for all things municipal within FINRA, and so we do bring these types of issues that come up on exams to the working group that I described with the SEC and the MSRB, and that really helps ensure that we're all consistent between the SEC and FINRA in terms of exam findings. We also -- you may have heard that there's another venues, we employ what we call disposition groups and for certain areas, there is a group of regulatory specialists in a particular area, including attorneys, who review exam findings and municipal securities is one of them. So for MSRB rules, and we will employ this for municipal adviser rules as well, we review all the exam findings across the country to make sure that the dispositions are consistent. So just because a firm is examined by the Chicago district office doesn't mean it will have a harsher penalty for a violation than someone -- a firm that was examined out of a New York district office, for example.

So that's kind of how it works within FINRA in terms of providing guidance to the staff -- not only with respect to the end of the exam, but all the way through the exam -- as they complete the process.

Robert Miller: All right. Well, I think we have a couple of questions from the audience that I'll just read. Steve, I think this first one is for you. "How often should a municipal adviser expect to be visited from the SEC?"

Steve Vilim: Oh, that's a good question. Again, it's going to depend on the final registration of the municipal advisers only. So obviously, we want to, I think, take it over a several-year period, two-year period across the regions. They'll be conducting examinations of the municipal adviser-only firms, the newly registered ones, and spread that over a period of two years. And then after that, it's depending on, I guess, our risk-based focus of your firm. So obviously, if you're a higher risk, then I would imagine, after that, you would get possibly more examinations.

Robert Miller: So this won't be on a cycle basis like FINRA exactly?

Steve Vilim: No, no, it won't.

Robert Miller: Okay. The other question is will the commission -- or "Does commission have reports similar to FINRA's focus reports? Will it contain a lot of the MA information -- financials, et cetera?"

Steve Vilim: I don't believe that we -- that's been, I guess, included, as far as your MA form, when you submitted it. So that's the reason why we're going to be asking for most of that data again when we show up.

Robert Miller: Okay. Another question we got -- again, to Steve -- is "I understand that when you arrive on site that you will interview individual municipal advisers. If so, will that interview take the place of you or your staff speaking with a chief compliance officer?"

Steve Vilim: No, that's going to be in addition to it. As I mentioned, when we get to the firm, we're going to want to know the general business of the firm, the supervisory structure. Obviously, the supervisory structure, a lot of its the compliance individuals typically sometimes serve as a point of contact. That's what I'm familiar with, definitely on the BD side when we conduct our exams. I've seen municipal advisers, sometimes can be sole proprietary, or you can have, I'd say, an outside chief compliance officer. That person may or may not be available at the time, but we do encourage that the compliance officer to attend those interviews and those meetings.

Robert Miller: And I know this had come up at a previous conference I attended, Steve. So you come in, your group comes in, you want to interview people. Do they need to have an -- do need to have attorney present? Do they need to have counsel? What's the next step?

Steve Vilim: That's your decision. If you feel comfortable with the adviser speaking freely to us, that's great. If you don't, then yes, please have your counsel available.

Robert Miller: Do we have any more questions? Yes, sir?

Male Speaker 3: Can we drill down to the suitability issue? I understand the SEC historically has put suitability from the investor's point of view. Like outside commodities and that sort of thing. But what about from the issuer point of view? What's the -- what -- what's the basis? And I can give you lots of examples in my practice as to recommendations that I believe is suitable. And suitability varies between my clients.

Male Speaker 3: A lot has -- depends on their risk tolerance. That's probably the major difference between them. Some are a little bit more risk-averse than others. It was suggested this morning that maybe we need a standard set of suitability standards that we have. But how do ours -- how do we apply ours to theirs? I mean, mine may not be theirs, but they're plenty comfortable with theirs. If you like, I could provide examples, but I wonder if we can get into that a little bit.

Robert Miller: So before you ask, Steve, I just need one point of clarification: So with meeting advisers, there will be a fiduciary duty standard? With obligated persons there'll be a suitability standard?

Steve Vilim: Yeah, my client's a generally obligated person, so I understand to be a suitability standard.

Robert Miller: Okay. So I would think, overall, you would use a standard similar to what FINRA has, and that's knowing your customers. So it won't -- one standard will not fit everybody. It'll just -- depending on your customer and your customer's business and what they're looking for and their knowledge.

Steve Vilim: A lot of their knowledge will be the result of what I've researched for them and presented, I believe, in a comprehensive and unbiased manner because, end of the day, I don't really -- I really don't care what they do as long as -- it's helpful that they've made a conscious decision that they're comfortable with. Yeah, I've not had a case where it's been just way off the wall somewhere. There's a central tendency to these -- to the decisions

they'll make, but variations, too. And I've had cases where they've done something that maybe I would not have done. I would've -- if it were up to me, and it's not, I would've done something a little different than what they ultimately decided to do. Is that okay?

Robert Miller: I mean, I think -- and Steve and I have both done broker-dealer exams where that's -- something similar has come up where the rep has said, you know, maybe you should do this or this, and the person says, well, no, I'm going to do x, y, and z. So what I'm saying is that I think the more you can document that you've had those discussions and you've brought it to their attention, I think that will put you on solid ground. I mean, it's all going to be facts and circumstances, but I think it's just something like that. You're going to have to document and show that you brought it to their attention and they just decided to go a different way.

Shawn O'Neill: And I would like to just interject. I think it also depends, too, on the specification of the -- your client. So are you -- are you talking about corporations that you're dealing with?

MaleSpeaker3: Nonprofit hospitals.

Robert Miller: Nonprofit hospitals.

Cindy Frelander: So these --

Male Speaker 3: Generally, smaller community hospitals.

Cindy Frelander: -- do they have investment policies, generally, or no?

Male Speaker 3: With -- in terms of investments of their own funds, yes

Shawn O'Neill: Okay.

Steve Vilim: I'm sorry.

Male Speaker 3:-- on which I rely heavily for recommendations with respect to investing bond proceeds.

Steve Vilim: Yeah, I mean, I would take a look at definitely their past history, their experience, how sophisticated they are. Getting -- as Robert talked about, too, is documenting your discussions with them so that it's clear to them about what you're trying to recommend to them and how sophisticated they are. And also, Dan has mentioned, too, understand their policies, their investment policies and their boards policies, and if you're making presentations to the boards at all, make sure they're very clear on what you're providing to them and their knowledge of the products.

Male Speaker 3:-- Well, I'm thinking of one case in particular where they've had investment policy because they had their own money and needed to put together a policy of how to invest it. In terms of borrowing money, they'd really never done it before, just in a small way. And Robert, this is the example I provided at the NAMA conference a few weeks ago. And you and your colleague kind of rolled your eyes when I said, "They've never issued debt before." And it was a -- it was a financing that involved Radian Insurance-backed auction rate securities with a Lehman swap and a reserve fund invested with AIG.

Steve Vilim: Right. And they --

Male Speaker 3:-- Guess what?

Robert Miller: They all failed. Yeah, I remember the scenario.

Male Speaker 3:-- And looking back on it, what we knew at the time, I still believe it was a solid recommendation. They were very comfortable with what they did. When it -- when it started to unravel, nobody was pointing any fingers, you know, you recommended this. It's like, okay, let's roll up the sleeves and do something about it. We're not going to stand idly by and take our lumps. Let's see how we can fix it, which is what we did in the beginning of the summer of '07, when Radian first experienced difficulty. So they were comfortable with it. Nobody -- there were no recriminations at all.

And looking back on the -- my -- the work we had done to present to their governing board, very state of the art. And it was based on what we knew at the time. It was very solid. So knowing what I know now, I wouldn't recommend that, but at the time, it made sense. And they were probably among my least risk-averse clients, so that, you know, they saw an opportunity to save money based on what we could tell, and they thought the risk was worth it.

But in an examination, how are you going to come to these judgments as to whether recommendations were suitable? It's -- part of it is knowing the client. And I'd been working with them a couple years at that point, so I knew them pretty well. But how is an examiner going to know these situations?

Robert Miller: Well, I think, for the most part, as we mentioned even back in the NAMA conference, it's not our job to kind of second guess you. I think the scenario you described, it was, you know, the perfect storm, I believe somebody said, where everything just kind of happened at once. So we wouldn't go back and say aha, you should've recommended this, that, or the other thing.

I think what is key, though, that all of us have said, you know, again, if you're looking at something that's either outside of their wheelhouse or something that they're not familiar, or even if it is, the more documentation you have, the better for our examiners in terms of looking at it and saying, well, you know, person x or firm y or MA z did everything a reasonable person could do, and it just was a bad situation. As opposed to saying, "Well, we did everything we could." And we'd say, "Well, show us how you came to that conclusion." And you said, "Well, I just talked to him on Monday, and he said that's what he was interested in."

Steve Vilim: And I think the other thing, too, I'd like to point out, too, is that we'll take a look at your firm, right? If this is your practice in recommending these types of products, that actually lends to your support. But if this is something you're just brand newly getting into and you're pitching this thing, we're going to start questioning whether or not, you know, the statistics --

Male Speaker 3:-- Well --

Steve Vilim: -- yeah.

Male Speaker 3:-- -- don't call it me pitching it. It was not -- these are not my products.

Steve Vilim: Okay.

Male Speaker 3:-- It was -- really had not been in a position to recommend this sort of thing before because I deal with weaker-credit clients, and this was one of the first ones that qualified for bond insurance. None of the rest of them were insurable. So I said, "Well, gee, now we've got Radian Insurance interested in this, this opens up these other possibilities."

Steve Vilim: Okay.

Male Speaker 3:-- So I knew it was out there; I'd never done it before. It's a function of the type of clients I have.

Steve Vilim: Right.

Robert Miller: So I think, as Steven mentioned -- and again, just to reiterate, we would have to look at the whole totality. It's difficult to give you a black and white answer now without --

Male Speaker 3:-- Well, I know, I know, I'm just --

Robert Miller: -- looking at everything and --

Male Speaker 3:-- But I could see the suitability issue getting to be a major point of contention with, you know, with all due respect, with SEC staff who have never looked at these issues before.

Robert Miller: Right.

Shawn O'Neill: You know, I guess what I would add to that -- and I agree with what Robert said. From the FINRA perspective, the suitability issue, we run across this not just in the muni space, but in other security spaces as well. And the biggest problem we have with our examining staff is that the firm can't document or evidence how they came to that conclusion or how they came to that determination. And to the extent that the firm has that documentation and they could tell us that story with the documents, I think, in most cases than not, I think we walk away satisfied that it appeared suitable.

Robert Miller: Another question over here.

Male Speaker 5: Specifically related to non-dealer MAs, I'm curious what you've done with your staff to bring them up to speed on our strange little world.

Steve Vilim: Sure. So what we've done and we're continuing to do, we're continuing to have training for our staff. We've gone over the new MA rules. We're having a training later on this year to go over the details, and we'll focus on the areas that we're going to be looking at as part of the SEC examination program. We're working with FINRA and the MSRB to get an understanding of the rules and regs with respect to the MAs. We will also, as Cindy mentioned, kind of -- we're working together to make sure that we're consistent on how we look at certain factual circumstances. So we are educating our examiners on this brand new world, and we're continuing to -- we will continue to do so in the future.

Shawn O'Neill: And the other thing I'd like to point out, too, as part of the OC's exam process, we have a National Exam Program, and we have working groups, and I'm one of the chairs, or the co-head, of the Fixed Income Working Group, and we meet on a regular basis to go over, you know, new topics, and particularly in this arena. And we do have

dedicated special examiners who come from the industry and understand what you guys are going through. So based on that and the monthly meetings and the other outreach that Robert's talking about, that's definitely -- our examiners are getting up to speed.

Male Speaker 6: Can I just ask what's the -- what's the objective of the review of fees and fee arrangements during examination?

Steve Vilim: Fees and fee --

Male Speaker 6: What's the objective of that review, that --

Steve Vilim: So what's the objective of reviewing fees and fees arrangements? I mean, it could be one of several things. It could be done as part of our review for fiduciary duty. It could come into supervision. It could come into pay to play. It could be a whole set of issues. It also could be part of the books and records requirements review.

Robert Miller: Do we have any more questions? All right, I think that's it. Well, thanks, everybody, for being here. I appreciate your participating.

[applause]

Male Speaker 2: If everyone could just wait, Dan Gregus is going to do closing remarks.

Dan Gregus: Thank you, everybody. As we're winding down today's program, I just want to mention a couple of housekeeping matters to start, and that is that soon after this program has ended, you'll be getting an email with an evaluation form, which we'd appreciate you taking a look at and getting back to us. It helps us determine what we're doing a good job here, what other issues we should target, it helps us to serve you, because while our objective is to protect investors, we also serve you at least to the extent that consistent compliance promotes confidence in the industry and is better for everyone. So we'd appreciate you filling out those forms if you get a chance. Secondly, I just want to remind you all that people who are looking to get CPE credit can still drop their forms off in the back there if you want to do so.

And I also want to remind you about the resources that are on both the thumb drive you received from the MSRB and in the packets that we provided you. Many of the statutes and regulations we look for, there's either links to those in those packets or information in the MSRB electronically. And I want to thank the fed for providing us with this wonderful space and with the technological assistant who sent out the information on a webcast. I want to thank the speakers for their efforts here, and I hoped that they provide you useful information. I want to thank the FINRA and MSRB as well for their sponsorship of this program. I hope that this has lifted the veil a little bit for you with respect to the SEC's, FINRA's, and the MSRB's thoughts and thought processes as we go forward in this area. And we look forward to being -- at least initially being a learning experience where we come to your firm and if we don't find a fraud or a serious conflict that has not been disclosed, we would hope that you would look at us as helping you improve your compliance going forward, to prevent something like that from happening in the future. And we look forward to working with you and learning as you are at the beginning of this process. So, with that, I want to thank you all again for attending, and I also want to turn it over to my colleague Michael Post from the MSRB to make additional closing remarks.

Michael Post: Thank you. I appreciate very much the opportunity to make some closing remarks. I can say on behalf of the MSRB and myself personally, and I think it's safe to say

the SEC and FINRA, we appreciate the opportunity to engage with members of the industry and particularly members of the municipal advisor community and hope that these really are sort of a win-win. I know that we appreciate hearing some of the practical implications of our rules and rule proposals, and hearing some of the practical concerns that you have. And I personally have enjoyed the conversations that I've had with a number of you at the breaks and in between sessions.

I wanted to talk a little bit about the things that you can do after today. One of them is I'd urge you to sign up, if you haven't already, for MSRB email updates. And these are the easiest way to keep up with the regulatory, educational or technology activities of the MSRB. We recognize that your industry's deeply affected by the developing regulatory framework for municipal advisors and I hope that, in the past, you've had the opportunity to avail yourselves of many of the things that the MSRB has been doing in the past year in terms of materials for you on preparing for regulation, participating in the rule-making process, and getting to know your regulator. And we've conducted webinars on each of the municipal advisor rule proposals. We've also held more lengthy comment periods for each municipal advisor rule proposal as traditionally has been allowed for rule proposals to give you the opportunity to digest, participate in the webinar, and make meaningful comments and participate in the process. In addition to the flash drives, I wanted to encourage you to avail yourself of additional resources for municipal advisors on the MSRB's webpage. We also have a recently launched education center that has tools for different market participants, including issuers.

And I would suggest that you consider a couple things that you could point your clients to that may be of benefit to them. One is that the MSRB has developed a functionality in EMMA for issuers to receive email reminders to prompt them when continuing disclosures are due and help ensure that those continuing disclosures are made on a timely basis. The second is that your clients can develop customized issuer homepages on EMMA and the MSRB is happy to work with issuer personnel on that and set up appointments to work with them and walk them through the process. So I think that this event, and Cindy spoke to it earlier, is a good example of the close working relationship that exists, particularly in this space, between the SEC, FINRA, and the MSRB, and we believe it's very helpful and we like to hope -- like to think that it's better for the market and better for the municipal advisory community that the three regulatory organizations that are striving to carry out their different mandates under Dodd-Frank and fulfill their different functions are communicating very well together and have close working relationships.

So thank you very much for attending today, for your time, and we'll look forward to hearing from you in the future. Thank you.

[applause]

[end of transcript]