MSRB
Municipal Securities
Rulemaking Board

September 19, 2011

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Response to Comments on File No. SR-MSRB-2011-11

Dear Ms. Murphy:

On August 11, 2011, the Municipal Securities Rulemaking Board (the "MSRB" or "Board") filed with the Securities and Exchange Commission (the "Commission") a proposed rule change consisting of amendments to Rule A-3, on membership on the Board. The Commission published notice of the above-referenced rule filing[1] and, in response, received letters from the Government Finance Officers Association ("GFOA"), the National Association of Independent Public Finance Advisors ("NAIPFA"), and the Securities Industry and Financial Markets Association ("SIFMA").

The Commission has requested that the MSRB provide its responses to these letters. The comments included in these letters are described below, together with the MSRB's responses. The MSRB appreciates input from these municipal market participants and has given their comments careful consideration.

Comments on Board Size

SIFMA opposed a permanent Board of 21 members for the following reasons:

- SIFMA said that a 21-member Board is too big, that any deviation from the Board size referenced in Section 15B of the Securities Exchange Act of 1934 (the "Exchange Act") should be for compelling reasons, and that the MSRB had not provided a strong justification for a 21-member Board.

- SIFMA also said that a 21-member Board would create problems in filling the "public" seats with members with sufficient knowledge and expertise in the municipal securities market to contribute effectively to the Board's discussions.

[1] Release No. 34-65158 (August 18, 2011); 76 FR 52724 (August 23, 2011).

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- SIFMA also said that a 21-member Board would impose unnecessary costs on the MSRB, specifically noting the marginal costs associated with a larger Board attributable to travel and related expenses for Board meetings and other events. SIFMA said that the MSRB's resources would be better directed to key initiatives to improve the functioning of the market.

MSRB Response Regarding Board Size

The Board believes that it has provided a strong justification for a 21-member Board. As the Board stated in its filing of the proposed rule change:

> While the Board proposes a composition greater than the statutory minimum of 15, the Board believes that this membership level is appropriate, given the diversity of the municipal securities marketplace and its constituencies, many of whom are required by statute to be represented on the Board. The Exchange Act requires the Board to have at least one retail or institutional investor representative, at least one municipal entity representative, at least one member of the public with knowledge of or experience in the municipal securities industry, at least one broker-dealer representative, at least one bank dealer representative, and at least one municipal advisor representative. Given the diversity of municipal entities, broker-dealers, bank dealers, and municipal advisors, a Board of 21 members provides more flexibility to provide representation from various sectors of the market. For example, at a 21-member level, the Board would be in a position to appoint municipal entity representatives that serve large and small constituencies, such as states and state agencies, cities, and other municipal entities, while at the same time retaining the flexibility to appoint academics and others with a broader view of the market. A smaller Board would be constrained in this regard. Moreover, at a 21-member level, the Board would be similar in size to its counterpart, the Board of Governors of the Financial Industry Regulatory Authority ("FINRA"), the self-regulatory organization that works closely with the Board to enforce Board rules applicable to FINRA members. Consequently, a Board of 21 members is appropriate and consistent with industry norms.

The Board does not agree with SIFMA's comment concerning the difficulty of filling the "public" seats with individuals with sufficient knowledge and expertise in the municipal securities market. The municipal securities market is replete with individuals who, while satisfying Rule A-3's definition of "independent," are very knowledgeable about the workings of the municipal securities market and have devoted a considerable amount of their time to the improvement of that

market. Previous MSRB searches for public Board members have elicited strong responses from such public servants.

While there obviously are additional costs associated with a larger Board, they are not substantial, as the Board places a strong emphasis on the importance of serving as a good steward of the fees paid to the Board by the parties the MSRB regulates. The MSRB estimates the incremental cost of the larger Board at approximately 1% of budget. The Board certainly does not consider such additional costs to be an impediment to the fulfillment of its key initiatives. Indeed, the additional insights all of the Board members benefit from as a result of a larger Board contribute significantly to those initiatives.

Comments on Board Composition

SIFMA opposed the MSRB's proposal to mandate that at least 30 percent of "regulated" members of the Board be representatives of municipal advisor firms that are not broker-dealers or bank dealers for the following reasons:

- SIFMA said that, under the proposed rule change, there would be no comparable minimum percentage for representatives of broker-dealers or bank dealers.

- SIFMA also said that the 30 percent minimum for municipal advisor representatives on the Board that are neither broker-dealers nor bank dealers significantly exceeds the statutory minimum, which states only that each regulated constituency -- broker-dealers, bank dealers, and municipal advisors -- have at least one representative on the Board.

- SIFMA also said that the MSRB had offered no justification for establishing a higher minimum representation for municipal advisors that are neither broker-dealers nor bank dealers than for any other constituency.

NAIPFA agreed with the Rule's requirement "that there be at least one municipal advisor representative who is not associated with a broker dealer in each elected class of Board members." However, NAIPFA said that the Board's composition of seven broker-dealer and bank dealer members, compared to three municipal advisor members, did not constitute "fair representation" of municipal advisors as was called for by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

GFOA made the following comments concerning the composition of the Board:

- GFOA said that, to ensure adequate issuer representation on the Board, a 21-member Board should include 4 issuer representatives, 4 investors, and 3 general public members. It said that the issuer positions should be filled by qualified and long-standing representatives of various-sized state and local governments so that

there would be a balanced representation of the issuer community. Furthermore, it said that the issuer representatives should generally come from general purpose governments that issue the most often used types of debt (*e.g.*, general obligation bonds, revenue bonds, etc.).

- GFOA also said that having an adequate number of "independent" financial advisors on the Board is essential and the number of such independent financial advisors should be no less than the aggregate number of bank and broker-dealer representatives. It suggested that only financial advisors who are truly independent and unaffiliated with banks and broker-dealer firms should be permitted to serve on the Board in the capacity of municipal advisor.

- GFOA also said that, in order for a public Board member to be considered "independent" from a regulated entity, such member should have had no material business relationship with a regulated entity for the past five years, rather than the two years provided for in Rule A-3. It also said that other criteria might also be needed to ensure that any particular independent board position would be filled by a professional that had significant experience in the particular community for which they served on the Board.

MSRB Response Regarding Board Composition

The MSRB has carefully considered the interests of municipal advisors, broker-dealers, and bank dealers as regulated entities, the MSRB's obligation to write rules that protect investors and municipal entities, and the statutory mandate that there be fair representation on the Board of broker-dealers, bank dealers, municipal advisors, and the public. While the statute requires that there be at least one municipal advisor representative on the Board, it is the view of the Board that no less than 30% of the members representing regulated entities should be municipal advisors that are not associated with broker-dealers or bank dealers, and, therefore, the MSRB does not agree with SIFMA's comment that this level of representation of municipal advisors is disproportionately large. Although the MSRB has made substantial progress in the development of rules for municipal advisors, its work is not complete. Indeed, over the years, it will continue to write rules that govern the conduct of municipal advisors and provide interpretive guidance on those rules, just as it has over the years for broker-dealers and bank dealers since it was created by Congress in 1975. Just as SIFMA considers it essential that broker-dealers and bank dealers participate in the development of rules that affect them, the MSRB believes that it is essential that municipal advisors participate in the development of rules that affect them. The MSRB believes that allotting at least 30% of the regulated entity positions to municipal advisors that are not associated with broker-dealers or bank dealers will assist the Board in its rulemaking process with respect to municipal advisors, and will inform its decisions regarding other municipal advisory activities while not detracting from the Board's ability to continue its

existing rulemaking duties with respect to broker-dealer and bank activity in the municipal securities market.

The MSRB also does not agree with NAIPFA's comment that this level of representation of municipal advisors is disproportionately small, in relation to the representation of broker-dealers and bank dealers. The MSRB notes that many broker-dealers and bank dealers engage in municipal advisory activities, so it is inappropriate to assume that the interests of the municipal advisor Board representatives and the broker-dealer and bank dealer Board representatives are adverse.

Regarding GFOA's comment on the adequacy of issuer representation on the Board, as the MSRB noted above, at a 21-member level, the Board would be in a position to appoint municipal entity representatives that serve large and small constituencies, such as states and state agencies, cities, and other municipal entities. The Board has also continued to reach out to organizations of issuer officials, such as the GFOA, to solicit their input on how the MSRB should go about its statutory mandate of protection of municipal entities. However, the MSRB does not believe that Rule A-3 should be amended to provide for a greater minimum number of municipal entity representatives than that mandated by the Exchange Act. With regard to the types of issuers that GFOA recommends as Board members, the MSRB notes that the Dodd-Frank Act directed the MSRB to protect all municipal entities, not just those that issue municipal securities. For example, the term "municipal entity," as defined in the Exchange Act, also includes public pension funds, 529 plans, and local government investment pools. The MSRB also believes that it has made great strides toward the protection of municipal entities in two 2011 groundbreaking proposals -- guidance on the duties of underwriters to issuers of municipal securities under MSRB Rule G-17[2] and a draft fiduciary duty rule for municipal advisors with municipal entity clients and associated interpretive guidance.[3] That guidance was promulgated even without the proposed changes to the Board's composition requested by GFOA, and the MSRB expects to issue significant proposals for the protection of municipal entities in the coming year.

As to GFOA's comment on the independence of municipal advisors, the MSRB notes that Rule A-3 requires that the municipal advisor representatives on the Board not be associated with any broker-dealer or bank dealer. Therefore, the rule language already addresses GFOA's concern that the municipal advisor representatives not be broker-dealers or bank dealers. The MSRB does not consider it necessary to have a greater number of such municipal advisors on the Board in order that they be fairly represented, particularly since broker-dealers and bank dealers may also be municipal advisors and may have interests aligned with non-dealer municipal advisors.

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2 *See* SR-MSRB-2011-09 (August 22, 2011).

3 *See* MSRB Notice 2011-48 (August 23, 2011).

Concerning GFOA's comment on the definition of "independent" in Rule A-3, the MSRB continues to believe, as it stated in 2010,[4] that:

> [T]he two year proposed cooling off period is appropriate as a standard for independence. Notably, other self-regulatory organizations with independence standards have only a one year cooling off period for public members who may have previously had a formal relationship with a regulated entity or other interested party. The standard proposed by the MSRB is twice as stringent. The MSRB believes that the two year period strikes the right conservative balance of ensuring sufficient independence while not permanently restricting individuals who are knowledgeable about the market – a requirement for all members of the Board under the Dodd-Frank Act – from ever serving on the Board. Furthermore, the definition of independent is not limited merely to a two year cooling off period, but also more broadly means that an individual has "no material business relationship" with any broker-dealer, bank dealer, or municipal advisor, including no relationship with a broker-dealer, bank dealer or municipal advisor, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision making of the individual. Finally the Board or its Nominating Committee could, either as a general matter or on a case-by-case basis, determine whether other circumstances involving the individual would constitute a material business relationship that would cause such person to be viewed as not being independent. Accordingly, the MSRB believes that no change in [the definition of "independent" in Rule A-3] is warranted.

Comments on Transparency of Board Processes

NAIPFA made the following comments concerning the transparency of the Board's processes:

- NAIPFA said that there should be additional transparency with regard to the process by which Board members are selected. They said that the Board members who are to serve on the Special Committee described in the proposed rule change had been selected prior to approval of the proposed rule change and requested that, in the future, the MSRB's Board member selection and leadership processes become more transparent.

- NAIPFA also requested that the Board adopt a more transparent rulemaking process. In particular, NAIPFA suggested that the MSRB post meeting agendas

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4 *See* MSRB Response of September 23, 2010 to Comments on File No. SR-MSRB-2010-08.

at least 48 hours in advance of a meeting date, and allow for public attendance at Board meetings and public participation in Board conference calls.[5]

- NAIPFA further requested that the MSRB ensure that statements made by its leadership are consistent with the actions of the Board, making a reference to press reports about the Board's consideration of amendments to MSRB Rule G-23.

MSRB Response Regarding Transparency of Board Processes

As to NAIPFA's comment on the selection of the members of the Special Nominating Committee in advance of the approval of the proposed rule change, by definition only those members who were selected could be considered "disinterested" in the selection process, because other Board members would, themselves, have been eligible to have their terms extended. Therefore, a different selection of Special Nominating Committee members would not be possible, even if conducted later. Moreover, the creation of the Special Nominating Committee was in accordance with the Board's Policies and Procedures and MSRB Rule A-6(a), which permits the Board to establish special committees by resolution. The creation of the Special Nominating Committee was a critical step in the transition process.

As the Board explained in the proposed rule change filing:

> In order to carry out the transition plan, the Board voted to create, by resolution, a Special Nominating Committee of five disinterested Board members to nominate certain Board members for extended terms. Disinterested Board members are those members who are ineligible for a term extension and, therefore, are less likely to have a personal interest in the nomination process that could affect their independent judgment. The class of 2011 is ineligible and, hence, disinterested because the term extensions would commence as of fiscal year 2013, and these members would no longer be on the Board at that time. Additionally, one public member from the class of 2012 is disinterested because the transition plan does not contemplate an extension for public members from that class. Therefore, there are six disinterested Board members, five of whom comprise the Special Nominating Committee, which includes three public members and two regulated members. The Chair of the Committee was selected from amongst the public members. The Board believes that a Special Nominating Committee of disinterested members, led by a public chair and with a public majority, is in the best position to nominate Board members for term extensions, in that these members are least likely to

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5 GFOA made a similar comment and requested that minutes of Board meetings be made available within 10 business days after each meeting.

have personal interests regarding the term extensions that could affect their independent judgments.

As to the comments of NAIPFA and GFOA on the transparency of the MSRB's rulemaking process, the MSRB believes that the existing rulemaking process provides considerable opportunities for full public involvement and comment on regulatory initiatives, and the Board is careful to consider all feedback regarding potential improvements to its governance processes. Recently, the Board made the Board member application process more transparent by establishing a policy of publishing the names of all applicants on the Board's website within one week of the publication of the names of the new Board members. Nevertheless, MSRB Board meetings are closed to the public and the media in order to promote free and frank discussion on all topics and to promote an environment in which impartial judgment may be exercised. However, the Board is exploring other alternatives to promote transparency and appreciates these comments, as transparency is an important priority of the Board.

As to NAIPFA's comment on the consistency of statements made by MSRB leadership with the actions of the Board, the MSRB does not believe that there has been any inconsistency. The statement in the *Bond Buyer* article concerning the continued review of Rule G-23 by the Board referred to in NAIPFA's letter was completely accurate.

If you have any questions, please do not hesitate to contact me.

Sincerely,

/s/ **Lawrence P. Sandor**

Lawrence P. Sandor
Senior Associate General Counsel

cc: Victoria Crane,
Division of Trading and Markets, SEC