

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-62755, File No. SR-MSRB-2010-02)

August 20, 2010

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Granting Approval of Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to MSRB Rule G-34, CUSIP Numbers and New Issue Requirements, to Enhance the Interest Rate and Descriptive Information Currently Collected and Made Transparent by the MSRB on Municipal Auction Rate Securities and Variable Rate Demand Obligations

I. Introduction

On March 10, 2010, the Municipal Securities Rulemaking Board (“MSRB”), filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to enhance the interest rate and descriptive information currently collected and made transparent by the MSRB on municipal Auction Rate Securities (“ARS”) and Variable Rate Demand Obligations (“VRDOs”). The proposed rule change was published for comment in the Federal Register on April 2, 2010.<sup>3</sup> The Commission received six comment letters about the proposed rule change.<sup>4</sup>

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 61793 (March 26, 2010), 75 FR 16878 (“Original Notice”) (the “original proposed rule change”).

<sup>4</sup> See letters from: Vladimir Drozdoff, Centerport, New York, dated April 4, 2010 (“Drozdoff Letter”); Joseph S. Fichera, Saber Partners, LLC, New York, New York (“Saber Partners”), dated April 12, 2010 (“Saber Letter”); Heather Traeger, Associate Counsel, Investment Company Institute (“ICI”), dated April 23, 2010 (“ICI Letter”); Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (“SIFMA”), dated April 23, 2010 (“SIFMA Letter”); Robert J. Stracks, Counsel, BMO Capital Markets GKST Inc. (“BMO Capital”), dated April 23, 2010 (“BMO Letter”) and Nik Mainthia, dated July 12, 2010 (“Mainthia Letter”).

On July 9, 2010, the MSRB filed with the Commission, pursuant to Section 19(b)(1) of the Exchange Act<sup>5</sup> and Rule 19b-4 thereunder,<sup>6</sup> Amendment No. 1 to the proposed rule change.<sup>7</sup> The Commission received no comment letters in response to Amendment No.

1. This order approves the proposed rule change as modified by Amendment No. 1.

II. Description of the Proposed Rule Change, As Modified by Amendment No. 1 to the Proposed Rule Change

The proposed rule change would enhance the interest rate and descriptive information currently collected and made transparent by the MSRB on municipal Auction Rate Securities (“ARS”) and Variable Rate Demand Obligations (“VRDOs”). The proposed rule change would: (i) amend MSRB Rules G-8, books and records, and G-34(c), variable rate security market information, to require brokers, dealers and municipal securities dealers (collectively “dealers”) to (a) submit to the MSRB documents that define auction procedures and interest rate setting mechanisms for ARS and liquidity facilities for VRDOs; (b) report to the MSRB ARS bidding information; (c) report to the MSRB additional VRDO information; and (d) communicate to an ARS Program Dealer the fact that an order submitted for inclusion in an auction is on behalf of an ARS issuer or conduit borrower (collectively “rule change proposal”); (ii) amend the MSRB Short-term Obligation Rate Transparency (“SHORT”) System Facility to collect and disseminate the documents identified in the rule change proposal (“SHORT System Facility amendment proposal”); and (iii) amend the MSRB EMMA Short-term Obligation Rate Transparency Service to make the documents collected in the SHORT

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<sup>5</sup> 15 U.S.C. 78s(b)(1).

<sup>6</sup> 17 CFR 240.19b-4.

<sup>7</sup> See Securities Exchange Act Release No. 62550 (July 22, 2010), 75 FR 44296 (“Notice of Amendment No. 1”).

System Facility amendment proposal available on the MSRB's Electronic Municipal Market Access (EMMA) website (the "EMMA Short-term Obligation Rate Transparency Service amendment"). A full description of the proposal is contained in the Notice of Amendment No. 1.

The MSRB has requested that the proposed rule change, which may be implemented in phases, be made effective on such date or dates as would be announced by the MSRB in notices published on the MSRB website, which dates would be no later than nine months after Commission approval of the proposed rule change and would be announced no later than sixty (60) days prior to the effective dates.

### III. Summary of Comments Received and the MSRB's Response

#### General Comments

The Commission received six comment letters<sup>8</sup> relating to the Original Notice.<sup>9</sup> The MSRB addressed the issues raised by the comment letters on the original proposed rule change in the Notice of Amendment No. 1. The Commission received no comment letters in response to the Notice of Amendment No. 1.

While the commenters indicated general support for the MSRB's effort to increase transparency of ARS and VRDO, four commenters on the original proposed rule change expressed concerns about various aspects of the proposal or suggested alternatives.<sup>10</sup> Two other commenters who have invested in ARS described problems

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<sup>8</sup> See supra note 4.

<sup>9</sup> See supra note 3.

<sup>10</sup> See Saber Letter, ICI Letter, SIFMA Letter and BMO Letter.

they had experienced in that market.<sup>11</sup> Mr. Drozdoff fully supported the proposal, noting that he held positions in two ARS and has been unable to obtain certain information about them. Mr. Drozdoff further stated that the lack of transparency creates the opportunity for manipulation and unfair dealing.

#### Additional VRDO Information

The original proposed rule change would increase the information that a VRDO Remarketing Agent would be required to report to the SHORT System. SIFMA expressed concern with the requirement in the proposed rule change for VRDO Remarketing Agents to report the identity of each tender agent and liquidity provider and maintain the accuracy of that information. SIFMA noted that the Remarketing Agent is not in privity of contract with the tender agent or the liquidity facility provider, that the identities of these parties may change and that the Remarketing Agent may not receive timely notification of such changes. SIFMA suggested that Remarketing Agents only be required to report such information on a “best efforts” basis.

The MSRB stated that it does not believe that it is appropriate for VRDO Remarketing Agents to be required only to exercise best efforts to report this information. Under the terms of the original proposed rule change, the VRDO Remarketing Agent would be required to modify any past submissions to the SHORT System in the event updated information about the tender agents and liquidity providers becomes known. In response to this comment, the MSRB provided in Amendment No. 1 that the requirement to report these identities is based upon information known to the VRDO Remarketing

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<sup>11</sup> See Drozdoff Letter and Mainthia Letter.

Agent as of the time of the interest rate reset. The Commission believes that Amendment No. 1 adequately addresses this concern.

SIFMA also expressed concern that the VRDO Remarketing Agent does not necessarily know the par amount of VRDOs, if any, held by a liquidity provider (“Bank Bonds”) at any point in time so that the VRDO Remarketing Agent would be able to obtain and report accurate information. SIFMA noted that VRDO Remarketing Agents may not know the precise amount of securities held as Bank Bonds as a result of revised amortization schedules for securities held as Bank Bonds as well as instances when holders tender securities directly to a tender agent. The MSRB noted in Amendment No. 1 that the proposal already adequately addresses SIFMA’s concern as it only requires VRDO Remarketing Agents to report the par amount of Bank Bonds based upon information available to the VRDO Remarketing Agent as of the time of the interest rate reset. The Commission agrees that the requirement is reasonable because the reporting requirement is limited to information available to the VRDO Remarketing Agent.

#### ARS Bidding Information

Saber Partners and SIFMA both stated that ARS bidding information required to be reported by ARS Program Dealers should be reported as individual data elements instead of as a word-searchable document. Saber Partners stated that greater transparency about the auctions would address some of the investor confidence issues created by the 2008 crisis and would encourage secondary market trading. Saber Partners also noted a large volume of ARS still outstanding that could benefit from additional market transparency. The MSRB agreed that having ARS bidding information collected as data elements would be a preferred method of data collection. The MSRB noted that

collection of data elements would facilitate data analysis and the computation of statistics, such as a bid-to-cover ratio, that would provide meaningful information about the demand for a specific ARS. Accordingly, in response to these comments, Amendment No. 1 requires ARS bidding information to be reported to the SHORT System as individual data elements. The Commission believes Amendment No. 1 adequately addresses their concerns.

SIFMA also expressed concerns with the requirement to report orders submitted by an issuer or conduit borrower. SIFMA noted that some issuers or conduit borrowers utilize a third party, such as an investment adviser or registered representative, for submitting orders to an ARS Program Dealer. In these cases, the ARS Program Dealer may not know that such orders are on behalf of issuers or conduit borrowers. To ensure ARS Program Dealers are provided with this information, Amendment No. 1 includes a new requirement for any dealer that receives an order for inclusion in an auction for ARS from an issuer or conduit borrower of such ARS to disclose this fact when submitting the order to an ARS Program Dealer. In Amendment No. 1, the MSRB also amended the original proposed rule change by removing the requirement to identify whether orders placed by an issuer or conduit borrower were executed. The MSRB noted that ARS Program Dealers would not be able to reliably ascertain whether orders on behalf of an issuer or conduit borrower submitted by a third-party dealer were executed, particularly if the third-party dealer submits more orders than just those on behalf of the issuer or conduit borrower and only some of those orders are filled.

SIFMA also suggested that the requirement to disclose the interest rate(s) and aggregate par amount(s) of orders to sell at a specific rate should be amended to read

“hold at a rate” to conform to current practice and documentation. SIFMA noted that when the rate drops below that customer’s “hold at” rate, the order is automatically converted into a sell order. The MSRB acknowledged in Amendment No. 1 that this requirement could be consolidated to simplify the rule language. The MSRB stated that Amendment No. 1 removes the requirement to report “sell at rate” orders as the remaining “hold at rate” and “sell at any interest rate” categories of orders should provide for the reporting of all sell orders.

#### ARS and VRDO Documents

The original proposed rule change would require ARS Program Dealers and VRDO Remarketing Agents to submit to the MSRB current and any new or amended versions of ARS documents defining auction procedures and interest rate setting mechanisms and VRDO documents consisting of liquidity facilities, including Letter of Credit Agreements and Stand-by Bond Purchase Agreements.

For existing documents, the original proposed rule change would require VRDO Remarketing Agents to make and document best efforts to obtain existing VRDO documents and specified a timeframe of ninety business days from the date of effectiveness of a rule change for dealers to submit such documents to the MSRB. For ARS documents, ARS Program Dealers would be required to submit existing documents to the MSRB no later than ninety business days from the date of effectiveness of a rule change. On an ongoing basis, the original proposed rule change included a requirement to submit new or amended versions of ARS and VRDO documents no later than one business day after receipt by the dealer.

ICI stated that timing is vital to the value of collecting and disseminating this information to investors. Accordingly, ICI supported the MSRB's original proposed submission deadline of 30 days from the date of the proposed rule change instead of the proposal's 90-day submission deadline. The MSRB agreed that it is important to have a centralized source of ARS and VRDO documents as soon as practical. Nonetheless, the MSRB believes that ninety days is an appropriate timeframe for having such documents submitted to the MSRB given the large number of documents that would need to be submitted to the MSRB and the fact that, for outstanding issues, dealers may need time to request documents from third parties.

ICI also stated that they strongly support the one-business-day submission requirement for new or amended versions of the ARS and VRDO documents. By contrast, SIFMA suggested that the deadline for submitting such new or amended documents be five business days after receipt. SIFMA stated that a one-business-day time frame is unduly burdensome for a broker dealer to submit documents to which it is not a party, noted the lack of a uniform manner in which dealers receive such documents from issuers and liquidity facility providers, indicated that it could take a couple of days internally at a broker dealer for these documents to get routed to the proper place and stated that there are approximately 16,500 outstanding VRDO transactions that are serviced by approximately 80 different Remarketing Agents. The MSRB concluded that a five-business-day deadline would be consistent with the timeframe for submitting advance refunding documents to the MSRB and would be an appropriate timeframe, at least initially, for such new or amended versions of ARS and VRDO documents to be submitted to the MSRB. Accordingly, in response to this comment, Amendment No. 1



provides a five-business-day deadline for submitting new or amended versions of ARS and VRDO documents to the MSRB. The Commission finds that the 90-business-day and the five-business-day submission deadlines are reasonable, at least initially.

SIFMA also requested clarification of the recordkeeping requirement for VRDO Remarketing Agents to document best efforts to obtain existing VRDO documents and asked whether such documents would be required to contain signatures. The MSRB, in response to this comment, amended the original proposed rule change in Amendment No. 1 to clarify that such records are only required to be kept for those documents that are unable to be obtained. The MSRB also noted that all documents would be required to be final, operative versions of such documents. The MSRB indicated that while this requirement does not necessarily require that the document be signed, the MSRB noted that signatures would provide a clear indication that the document reflects a final version. The Commission believes that Amendment No. 1 adequately clarifies this issue.

#### Other Comments

ICI recommended that the MSRB consider expanding the proposed disclosures to ensure a more complete picture of the risks associated with ARS, VRDOs and other variable rate securities, such as “credit enhancement” data and documentation. In addition, ICI recommended that the MSRB create a “miscellaneous” or “catch-all” category of variable rate securities to provide investors with material information about new products. The MSRB noted a separate MSRB initiative to display on EMMA information offered by credit ratings agencies would provide additional access to credit enhancement features associated with municipal securities on a market-wide basis.<sup>12</sup> The

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<sup>12</sup> See MSRB Notice 2010-13 (May 20, 2010).

MSRB agrees that new products may benefit from the transparency offered for ARS and VRDO by the SHORT System, and plans to review in the future whether changes to the SHORT System and associated rules could accommodate future products without subsequent system and rule modifications.

With regard to all other issues raised by the commenters, the Commission believes that the MSRB has adequately addressed the commenters' concerns.

#### IV. Discussion and Commission Findings

The Commission has carefully considered the proposed rule change, the comment letters received, and the MSRB's responses to the comment letters and finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the MSRB<sup>13</sup> and, in particular, the requirements of Section 15B(b)(2)(C) of the Exchange Act<sup>14</sup> and the rules and regulations thereunder. Section 15B(b)(2)(C) of the Exchange Act requires, among other things, that the MSRB's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.<sup>15</sup> In

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<sup>13</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>14</sup> 15 U.S.C. 78o-4(b)(2)(C).

<sup>15</sup> Id.

particular, the Commission believes that the proposed rule change would serve as an additional mechanism by which the MSRB works toward removing impediments to and helping to perfect the mechanisms of a free and open market in municipal securities by providing a centralized venue for free public access to information about and documents relating to ARS and VRDO. The proposed rule change would provide greater access to information about and documents relating to ARS and VRDO to all participants in the municipal securities market on an equal basis thereby removing potential barriers to obtaining such information. These factors serve to promote the statutory mandate of the MSRB to protect investors and the public interest.

V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Exchange Act and the rules and regulations thereunder applicable to the MSRB<sup>16</sup> and, in particular, the requirements of Section 15B(b)(2)(C) of the Exchange Act<sup>17</sup> and the rules and regulations thereunder. The proposal will become effective as requested by the MSRB.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange

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<sup>16</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>17</sup> 15 U.S.C. 78o-4(b)(2)(C).

Act,<sup>18</sup> that the proposed rule change (SR-MSRB-2010-02), as amended, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>19</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>18</sup> 15 U.S.C. 78s(b)(2).

<sup>19</sup> 17 CFR 200.30-3(a)(12).