

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-65992, File No. SR-MSRB-2011-19)

December 16, 2011

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1 Thereto, Consisting of Amendments to Rule G-16, on Periodic Compliance Examination, and Rule G-9, on Preservation of Records

I. Introduction

On October 13, 2011, the Municipal Securities Rulemaking Board (“MSRB” or “Board”), 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 consisting of amendments to Rule G-16, on periodic compliance examination, and Rule G-9, on preservation of records. The proposed rule change was published for comment in the Federal Register on November 1, 2011.<sup>3</sup> The Commission received two comment letters regarding the proposed rule change and the MSRB’s response to those comment letters.<sup>4</sup> On December 12, 2011, the MSRB filed with the Commission, pursuant to Section 19(b)(1) of the Exchange Act<sup>5</sup> and

---

<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. 65631 (October 26, 2011), 76 FR 67503 (November 1, 2011) (the “Commission’s Notice”).

<sup>4</sup> See letter from David L. Cohen, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (“SIFMA”), dated November 21, 2011 (“SIFMA Letter”); letter from Tamara K. Salmon, Associate General Counsel, Investment Company Institute (“ICI”), dated November 22, 2011 (“ICI Letter”); and letter from Lawrence P. Sandor, Senior Associate General Counsel, Municipal Securities Rulemaking Board (“MSRB”), dated December 12, 2011 (“MSRB Letter”).

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

Rule 19b-4 thereunder,<sup>6</sup> Partial Amendment No. 1 (“Amendment No. 1”) to the proposed rule change.<sup>7</sup> The Commission is publishing this notice and order to solicit comment on Amendment No. 1 and to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

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

Pursuant to Section 15B(b)(2)(E) of the Exchange Act,<sup>8</sup> MSRB rules must provide for the periodic examination of municipal securities brokers, municipal securities dealers, or municipal advisors (“regulated entities”) to determine compliance with Section 15B of the Exchange Act, the rules and regulations thereunder, and MSRB rules. The same provision requires that the MSRB specify the minimum scope and frequency of the examinations and that the examination rules be designed to avoid unnecessary regulatory duplication or undue regulatory burden for any regulated entity.

Section 15B(c)(7) of the Exchange Act<sup>9</sup> provides that the periodic examination of regulated entities shall be conducted by (a) a registered securities association in the case of dealers that are members of the registered securities association, (b) the appropriate regulatory agency (“bank regulators”) in the case of dealers that are not members of a registered securities association, and (c) the SEC, or its designee, in the case of municipal

---

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

<sup>7</sup> Amendment No. 1 to the proposed rule change requested that the Commission approve the amendment to Rule G-9 with an effective date that is six months from the date of the approval order. The text of Amendment No. 1 and the MSRB Letter are available on the MSRB’s website at <http://www.msrb.org>, at the principal office of the MSRB, and at the Commission’s Public Reference Room.

<sup>8</sup> 15 U.S.C. 78o(b)(2)(E).

<sup>9</sup> 15 U.S.C. 78o(c)(7).

advisors. There is one securities association registered with the SEC – FINRA.

Approximately 1,800 MSRB registered dealers are members of and examined by FINRA, with the remaining dealers registered with the SEC as municipal securities dealers and examined primarily by the various federal bank regulators.

Rule G-16 currently provides that, at least once every two calendar years, dealers must be examined in accordance with Section 15B of the Exchange Act in order to determine whether the dealers are in compliance with all MSRB rules and applicable provisions of the Exchange Act. Separately, FINRA examines its members pursuant to a risk-based approach at least every four calendar years. In order to comply with Rule G-16, FINRA and the MSRB agreed to a protocol allowing for a questionnaire to be completed by certain firms every two calendar years. These dealers are typically less active in the municipal securities market and, therefore, pose less overall risk to market participants. The questionnaire, entitled the Alternative Municipal Examination (“AME”) module, was implemented in 1998, after review by SEC and MSRB staff. The AME is used as an off-site examination for low-risk dealers that: (a) conduct a limited municipal securities business; (b) do not conduct a public finance business; and (c) are not otherwise identified as high risk firms for regulatory purposes. The AME is necessarily general and not tailored to the specific business of any one firm. It relies on each responding dealer to self report rule violations and to certify that the information provided is truthful and accurate.

After many years of experience with the AME, the MSRB and FINRA believe that a more risk-based examination protocol should be implemented and that Rule G-16 should be amended to allow for up to a four year examination cycle for FINRA-member

firms, consistent with FINRA's requirement for cycle examinations of all other FINRA members. This would also allow FINRA to integrate the municipal securities cycle examination program more closely with its overall cycle examination program, and redeploying staff resources from administering the AME to participating in the risk-based examination program would foster more meaningful oversight. Moreover, over the last few years, there have been significant advances in information technology, particularly with the development of the MSRB's Real-time Transaction Reporting System and Electronic Municipal Market Access system. These advancements in information technology and transparency have enabled FINRA to develop robust automated surveillance reviews of municipal securities transactions. FINRA is now able to review municipal securities transactions and other activity remotely in order to identify potential MSRB rule violations by dealers. These tools permit FINRA staff to conduct near real-time surveillance of certain municipal securities activities.

The municipal securities business has also changed dramatically over the last few years. The industry has consolidated and a small number of large firms account for the majority of public finance business. The top five underwriters accounted for over 50 percent, by par amount, of primary offerings in 2010 and 2011.<sup>10</sup> The top 10 underwriters accounted for over 70 percent of the underwritings, by par amount, in 2010 and 2011, and the top 200 accounted for almost 100 percent of the underwritings, by par amount, in 2010 and 2011. According to data gathered by the MSRB, the top 10 dealers executed approximately 55 percent of all municipal securities transactions reported to the MSRB in 2010 and 2011. The top 50 dealers executed approximately 80 percent of all

---

<sup>10</sup> All 2011 figures are through September 2011. Underwriting statistics are provided by Thomson Reuters.

such transactions in 2010 and 2011, and the top 200 dealers executed approximately 96 percent of all such transactions. By par amount, the top 200 dealers executed approximately 98 percent of all municipal securities transactions reported to the MSRB in 2010 and 2011. The remaining approximately 1,600 firms are less active in the municipal securities market, engage solely in the sale of interests in 529 College Savings Plans, or effect municipal securities transactions primarily as an accommodation to their customers. Generally, these firms are not engaged in financial advisory activities or municipal securities underwriting, research, or trading. They, therefore, do not pose systemic risk to the market in these areas.

With input from the MSRB, consistent with Section 15B(b)(4) of the Exchange Act,<sup>11</sup> FINRA is enhancing its risk assessment approach to rank dealers by certain risk factors, as well as by size and scope of business, to determine their examination cycle frequencies, which under the proposed rule change would range from one to four years, rather than every two years as currently prescribed by Rule G-16. It is anticipated that, based on the analysis of the various identified risks and related factors, those firms that represent higher risks, as well as firms that pose a systemic threat based on the scope and scale of their underlying municipal securities activities, would be examined on an annual basis. Other firms would be examined less frequently, every two to four years, depending on the risk ranking and size of their municipal securities business and the firm's overall business model. At a minimum, all firms would be examined at least once every four calendar years. Cycle examination frequencies for dealers would be re-assessed at least on an annual basis. FINRA would continue to conduct off-site

---

<sup>11</sup> 15 U.S.C. 78o(b)(4).

surveillance of municipal securities activity and “cause” examinations as needed.

“Cause” examinations are event-driven and typically initiated as a result of customer complaints, regulatory tips, and other information sources identified by FINRA via its regulatory oversight process.

The MSRB believes that using quantitative and qualitative criteria to rank dealers by appropriately identified risk measures and size no less frequently than on an annual basis provides better protection for investors, municipal entities, and other market participants, since FINRA’s resources will be focused on those firms that pose the greatest risk to investors, municipal entities and the market. Such firms will be subject to in-depth examinations tailored to the specific municipal securities activities they conduct.

Finally, the MSRB is also proposing to change MSRB Rule G-9 to require dealers that are FINRA members to retain certain records for four years, rather than for three years, in order to ensure that the records are available at those firms that are examined every four calendar years.

### III. Discussion of Comments and MSRB’s Response

As previously noted, the Commission received two comment letters on the original proposed rule change.<sup>12</sup> Both commenters expressed support for the proposed amendments to Rule G-16, which would allow FINRA and the MSRB to establish a risk-based compliance program consistent with FINRA’s requirement for cycle examinations of all other FINRA members. One commenter, however, did not support the proposed amendments to Rule G-9, which would extend certain record-keeping requirements from

---

<sup>12</sup> See supra note 4.

three to four years, stating that such change is not warranted to support the proposed changes to the frequency of the cycle examinations.<sup>13</sup>

ICI stated that it supported the proposed revisions because they should result in a more efficient examination process without diminishing the effectiveness of the MSRB's oversight. ICI further stated that changes in technology and in the municipal securities business provide the MSRB greater access to information on registrants, thereby reducing the need for frequent examinations of registrants. Finally, ICI stated that in instances where there is cause for the MSRB to conduct more frequent examinations of a particular registrant, its ability to do so is not impeded by the revisions.

Although SIFMA believes that the current examination cycle appears to be working adequately, SIFMA supports the proposed rule change. SIFMA stated that the proposed rule change would facilitate the modernization of the examination process for dealers and permit greater flexibility in the administration of periodic compliance examinations in order to focus more closely on those dealers that, by virtue of various identified factors, pose the greatest risk to investors, other market participants, and the municipal securities market. SIFMA further stated, however, that it believes that such identified factors should be specifically enumerated by FINRA and the MSRB after further discussions with interested market participants. SIFMA concluded that changes to a dealer's examination cycle frequency should not be implemented until this process is complete. Additionally, SIFMA stated that since the voluminous real-time transaction data received by the MSRB on a daily basis has allowed FINRA to develop robust

---

<sup>13</sup> See SIFMA Letter.

automated surveillance reviews of municipal securities transactions, it is critical that such data be leveraged to maximize the efficiency of on-site visits.

The MSRB noted that FINRA is the designated examination and enforcement authority for its members that are MSRB registered dealers. The MSRB further noted that although the MSRB provides advice and consultation on examination and enforcement matters, the authority for such examinations rests solely with FINRA for its member firms. While the MSRB has generally described the considerations in determining the frequency of a dealer's examinations, such as the size and scope of its business, the MSRB believes it important to maintain confidentiality of the specific risk factors and not make them a matter of negotiation. Moreover, the MSRB stated that the risk factors are dynamic, and additional risk factors may be utilized as new risks emerge and existing risks are mitigated by market conditions or business practices. The MSRB believes that it would not be in the public interest to refrain from changing a dealer's examination cycle until there is disclosure and consultation with market participants. The MSRB stated that it agrees that transaction reporting by dealers provides an important source of information regarding dealer activity in the municipal securities market, and that the information is, and will continue to be, of value in surveillance and examinations of dealers.

With respect to the proposed changes to MSRB Rule G-9, SIFMA stated that the current three year/six year/and lifetime record-keeping categories as set forth in Rule G-9 are sufficient and have long been an industry standard. SIFMA believes that the proposed four-year record-keeping requirement is unnecessarily burdensome for member firms, and that the MSRB's only stated reasoning for increasing the retention period for



certain records is to mirror the proposed four-year examination cycle. SIFMA further stated that, in order to function efficiently, dealers should be subject to consistent record-keeping requirements across product lines. SIFMA also stated that satisfying these regulations requires dealers to implement procedures, technology and training and that a well-established standard such as the current one should not be changed without a more comprehensive discussion of all related issues, including cost estimates compared to anticipated benefits.

In addition, SIFMA stated that real-time transaction data is available for review on a daily basis. SIFMA noted that when a periodic examination is conducted, FINRA reviews a sampling of transactions occurring during the period of review. SIFMA stated that the substantial costs of requiring additional record-keeping for all dealers (especially those dealers that are examined on an annual or semi-annual basis) so that certain records would be available to review at those dealers that are examined in year four of the proposed four-year review cycle ( i.e., dealers with the smallest footprint or risk profile) should be weighed against the nominal benefit of allowing FINRA to review a few records from “year one” for that subset of dealers.

The MSRB stated that the proposed rule change is not a significant departure from current record-keeping standards and will not impose an unnecessary burden on dealers that are already subject to a variety of different record retention requirements. Rule G-9 provides that, for dealers that are FINRA members, certain records must be retained for three years, while other records must be retained for six years or for the life of the enterprise. The proposal would extend the record retention obligation for certain records by one year. The MSRB stated that the retention of these records for one

additional year is necessary to accommodate the four-year examination cycle for certain FINRA-member dealers and serves a clear regulatory purpose.

SIFMA also noted that, to their knowledge, the MSRB has not conducted a cost-benefit analysis regarding the impact of the proposed changes to Rule G-9. SIFMA requested that such cost-benefit analysis be conducted prior to implementing the proposal. In response, the MSRB stated that it does not believe that the proposal to retain certain records for an additional year will impose an undue burden on dealers or require substantial changes to their systems or procedures, since the rule would merely require that the records be retained for one additional year. Additionally, given the limited nature of the change proposed, a cost-benefit analysis is unwarranted, since the records are already being retained by dealers and any incremental storage cost and one-time transitional burden of modifying policies and systems should be relatively minimal for firms already in compliance with the existing MSRB and FINRA record-keeping rules, with such costs clearly outweighed by the necessity to accommodate the four-year examination cycle for a significant number of FINRA members.

SIFMA requested that, if the changes to Rule G-9 are approved, the effective date be at least one year from the date of the Commission's approval, in order to provide dealers with an opportunity to modify their policies and systems to comply with the new retention schedule. The MSRB believes that an extended effective date for Rule G-9 is appropriate but does not believe that a full year is necessary to comply with a new record retention period. Amendment No. 1 would partially amend the original proposed rule change by requesting that the Commission approve the amendments to Rule G-9 with an effective date that is six months from the date of the Commission's approval order. The

MSRB believes that six months is an appropriate period to permit dealers to modify their policies and systems to comply with the rule change.

#### IV. Discussion and Commission Findings

The Commission has carefully considered the proposed rule change, the comment letters received, and the MSRB's response to the comment letters and finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the MSRB.<sup>14</sup> The Commission believes that the proposed rule change is consistent with the provisions of Section 15B(b)(2)(E) of the Exchange Act,<sup>15</sup> which authorizes the MSRB to provide for the periodic examination, in accordance with Section 15B(c)(7) of the Exchange Act,<sup>16</sup> of municipal securities brokers, municipal securities dealers, and municipal advisors to determine compliance with the applicable provisions of the Act, the rules and regulations thereunder, and the rules of the MSRB. Section 15B(b)(2)(E) of the Exchange Act<sup>17</sup> also provides that the rules of the Board shall specify the minimum scope and frequency of such examinations and shall be designed to avoid unnecessary regulatory duplication or undue regulatory burdens for any such municipal securities broker, municipal securities dealer, or municipal advisor.

---

<sup>14</sup> In approving the 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>15</sup> 15 U.S.C. 78o(b)(2)(E).

<sup>16</sup> 15 U.S.C. 78o(c)(7).

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

The Commission also believes that the proposed rule change is consistent with the provisions of Section 15B(b)(2)(G) of the Exchange Act<sup>18</sup> which authorizes the MSRB to prescribe records to be made and kept by municipal securities brokers, municipal securities dealers, and municipal advisors and the periods for which such records shall be preserved.

The proposed rule change will more closely align the records required to be made and kept by municipal securities brokers, municipal securities dealers and municipal advisors pursuant to Rule G-9 with the records already required to be made and kept by FINRA, thereby reducing the administrative burden on such municipal securities brokers, municipal securities dealers and municipal advisors.

The Commission believes that the MSRB has adequately responded to the concerns expressed in the comment letters. The Commission agrees with the MSRB that the requirement to retain certain records for an additional year will not impose an undue burden on municipal securities brokers, municipal securities dealers and municipal advisors or require substantial changes to their systems or procedures because the records are already being retained. Further, the Commission agrees with the MSRB that any incremental cost and burden of modifying policies and procedures should be minimal, with such cost and burden outweighed by the necessity to accommodate the four-year examination cycle for a significant number of FINRA members.

V. Order Granting Accelerated Approval of Proposed Rule Change

---

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

Pursuant to Section 19(b)(2) of the Exchange Act,<sup>19</sup> the Commission may not approve any proposed rule change, or amendment thereto, prior to the 30<sup>th</sup> day after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding. The Commission hereby finds good cause for approving the proposed rule change, as modified by Amendment No. 1, before the 30<sup>th</sup> day after the date of publication of notice of filing thereof in the Federal Register. Amendment No. 1 would partially amend the original proposed rule change by requesting that the Commission approve the amendments to Rule G-9 with an effective date that is six months from the date of the Commission approval order. Originally, the proposed rule change to Rule G-9 would have become effective as of the date of the Commission approval order. While the MSRB does believe it appropriate to provide dealers with time to revise their policies and procedures, systems and controls to accommodate the longer retention period, the MSRB believes that such changes can be accomplished in a shorter time frame. The MRSB stated that the modest extension of the retention period for certain records does not warrant such a delayed effective date as requested by SIFMA. Rather, the MSRB believes that in light of the clear importance of preserving records for the entire period between FINRA examination cycles, and the modest increase in the current retention period, six months is an appropriate period to permit dealers to modify their policies and systems to comply with the rule change. The Commission does not believe that Amendment No. 1 significantly alters the proposal and that the six-month extension in the effective date of the amendments to Rule G-9 is reasonable. The Commission believes that Amendment No. 1 is consistent with the

---

<sup>19</sup> 15 U.S.C. 78s(b)(2).

proposal's purpose and raises no new significant issues. Accordingly, pursuant to Section 19(b)(2) of the Exchange Act,<sup>20</sup> the Commission finds good cause to approve the proposed rule change, as amended, on an accelerated basis.

#### VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-MSRB-2011-19 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-MSRB-2011-19. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed

---

<sup>20</sup> 15 U.S.C. 78s(b)(2).

with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the MSRB. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2011-19 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,<sup>21</sup> that the proposed rule change (SR-MSRB-2011-19), as modified by Amendment No. 1, be, and it hereby is, approved. The proposed amendment to Rule G-16 will become effective as of the date of this approval order and the proposed amendment to Rule G-9 will become effective six months after the date of this approval order.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>22</sup>

Kevin M. O'Neill  
Deputy Secretary

---

<sup>21</sup> 15 U.S.C. 78s(b)(2).

<sup>22</sup> 17 CFR 200.30-3(a)(12).