MSRB
Municipal Securities Rulemaking Board

November 19, 2010

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-2010-10 Relating to Proposed Amendments to MSRB Rule A-13, on Underwriting and Transaction Assessments for Brokers, Dealers and Municipal Securities Dealers

Dear Ms. Murphy:

On October 13, 2010, the Securities and Exchange Commission (the "SEC" or "Commission") published notice of the above-referenced rule filing[1] and, in response, received ten comment letters.[2] The Commission has requested that the MSRB respond to the comments.

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1 Exchange Act Release No. 34-63095 (October 13, 2010); 75 FR 64372 (October 19, 2010).

2 Comments and Letters of Bond Dealers of America ("BDA") (Nov. 9, 2010); Coastal Securities, Inc. ("Coastal Securities") (Nov. 8, 2010); Edward Jones ("Edward Jones") (Nov. 9, 2010); Government Finance Officers Association ("GFOA") (Nov. 9, 2010); Hartfield Titus & Donnelly, LLC ("HTD") (Nov. 9, 2010); Morgan Stanley Smith Barney LLC ("MSSB") (Nov. 10, 2010); RW Smith Associates, Inc. ("RW Smith") (Nov. 9, 2010); Securities Industry and Financial Markets Association ("SIFMA") (Nov. 9, 2010); Southwest Securities, Inc. ("Southwest Securities") (Nov. 9, 2010); and TD Ameritrade Holding Corporation ("TD Ameritrade") (Nov. 9, 2010).

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The MSRB appreciates input from these municipal market participants and responds to the comments below.

Background

On September 30, 2010, the MSRB filed with the Commission a proposed rule change relating to assessments for brokers, dealers, and municipal securities dealers ("dealers") under MSRB Rule A-13. The proposed rule change consists of amendments to Rule A-13 to increase transaction assessments for certain municipal securities transactions reported to the Board and to institute a new technology fee on reported sales transactions. Specifically, the proposed rule change would amend Rule A-13 to (a) increase the existing transaction assessments for inter-dealer and customer sales from .0005% to .001% of the total par value of inter-dealer sales and sales to customers that are reported by dealers to the MSRB, subject to certain existing exemptions (the "transaction fee"), and (b) impose a technology fee of $1.00 per transaction for all inter-dealer and customer sales reported to the Board (the "technology fee"). The technology fee would be transitional in nature and would be reviewed by the Board periodically to determine whether it should continue to be assessed. The MSRB proposed an effective date for this proposed rule change of January 1, 2011.

Discussion of Comments

The principal comments of the commenters, and the MSRB's responses, are set forth below:

- **Justification for Revenue Increase:** While many commenters acknowledged that the MSRB's activities have expanded due to its recent technology initiatives and enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), commenters generally felt that the MSRB did not provide sufficient justification for an increase of such size,[3] with several commenters stating that the MSRB should provide details on matters such as projections of operational costs, expected revenue in future years, projected budgets, financial forecasts and planned technology initiatives in requesting such a large increase in revenue.[4] Some commenters noted that the increase in fees was sought

[3] BDA, Coastal Securities, GFOA, HTD, MSSB, RW Smith, SIFMA, Southwest Securities and TD Ameritrade. Some commentators calculated the size of the increase in MSRB revenues over the previous year to be approximately 80%. *See* BDA, HTD, RW Smith, SIFMA and TD Ameritrade.

[4] BDA, Coastal Securities, GFOA, HTD, RW Smith, SIFMA and TD Ameritrade.

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without industry input prior to the filing of the proposed rule change and that additional dialogue with industry participants should be undertaken before determining the appropriate funding levels and manner of assessing fees.[5] Two commenters stated that the MSRB should include consideration of revenues from fine sharing with FINRA.[6]

While it did not provide the level of detailed analysis of projected operating expenses and revenues sought by many of the commenters, the MSRB has noted the reasons that the revenue increase that would result from the proposed rule change is reasonable, appropriate and in the best interest of all market participants. As noted in the rule filing, the MSRB's 2009 audited financial statement reflected an increase in expenses from $18.6 million for the fiscal year ended September 30, 2008 to $21.3 million for the fiscal year ended September 30, 2009, representing an increase of 14.5%. This significant increase in expenses for the fiscal year ended September 30, 2009 reflects the many recent MSRB initiatives in support of the MSRB's investor protection mandate, including the development and launch of the primary market disclosure electronic library, the collection of secondary market disclosures, establishment of our Short-Term Obligation Rate Transparency (SHORT) system for interest rate resets, the Electronic Municipal Market Access (EMMA) system for display of disclosures and trade data, and other enhancements to our information systems.

The fiscal year ended September 30, 2010 represented the first full year of operation of most of these important marketplace enhancements. Data for that fiscal year was not yet available at the time the MSRB submitted its filing with the Commission; at this time, although the audit of the MSRB's financial statements for the fiscal year ended September 30, 2010 has not yet been completed, the MSRB expects that expenses for that fiscal year to be approximately $23.1 million, representing an additional increase of 8.5% over the previous year, including an increase in market information transparency program expenses of 13%. The MSRB expects expenses for the two fiscal years ending September 30, 2011 and 2012 to increase at significantly higher rates than for either of the prior two fiscal years as a result of the several factors mentioned in the filing with the Commission.

A significant portion of these expected increases in expenses relates to the continued operation and further enhancement of the MSRB's new information systems, including on-going establishment of sophisticated new functionality. A number of these technology initiatives are well known to the municipal securities industry through the MSRB's prior notice and comment process and its filings with the Commission, including free public access to credit ratings and

[5] GFOA, HTD, MSSB, RW Smith, SIFMA and Southwest Securities.

[6] GFOA and SIFMA.

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related information, the submission and public availability of additional information and key documents regarding auction rate securities and variable rate demand obligations, additional continuing disclosures as a result of amendments to SEC Rule 15c2-12, voluntary posting of preliminary official statements and other primary market documents by issuers, and additional voluntary continuing disclosures submitted by issuers, obligated persons and their agents. Maintaining the EMMA and SHORT systems, together with the Real-Time Transaction Reporting System ("RTRS"), ensuring their operational stability, and employing sound risk management practices, including adequate redundancies, must be a priority. Any new functionality added to any of these systems would result in additional costs beyond the baseline operating costs of the MSRB. Accompanying this rapid growth is the need to assure a stable and flexible technology and operational infrastructure with the appropriate levels of redundancy to assure continuous public access.

In undertaking its various information systems, the MSRB has not previously set aside reserves for replacement of these systems, instead relying on its general operating reserves to fund all development and any systems upgrades and replacements. Certain of the existing public information systems operated by the MSRB, including RTRS and the public access system for Forms G-37 under Rule G-37, on political contributions and prohibitions on municipal securities business, now rely on dated technology and can be expected to need comprehensive re-engineering in the coming years. With regard to future technology and other initiatives to be undertaken by the MSRB, the Board undertakes long-range strategic planning and has in place a prioritization process to ensure that such initiatives are undertaken only after careful review of their merits and the resources available to the MSRB to properly fund the development and operation of such initiatives. This review includes a consideration of the costs and benefits of undertaking such activities, with such costs and benefits including not only economic factors but also less quantifiable factors relating to protection of investors, municipal entities, obligated persons and the public interest as well as factors relating to the maintenance of a fair, free and open market for municipal securities and municipal financial products. As always, externally facing technology initiatives normally must be undertaken through the normal MSRB rulemaking process, which includes extensive opportunity for public comment. The MSRB believes that this is the appropriate process for receiving input from industry participants with regard to its regulatory and information system initiatives, rather than through a process whereby industry participants could seek to influence which initiatives the MSRB pursues by attempting to limit the resources available to it.

Additionally, as the MSRB noted in the rule filing, the Dodd-Frank Act expands the mission and jurisdiction of the MSRB. The MSRB needs a substantial increase in funding to satisfy its obligations under the new law, which requires the MSRB to draft rules regarding the activities of municipal advisors as well as rules for the protection of municipal entities and obligated persons.

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Finally, the MSRB acknowledges that the Dodd-Frank Act requires the Commission and FINRA to share fines levied as a result of MSRB rule violations. Any revenues derived from such provision would, of course, be taken into account as the MSRB prepares future budgets and reviews its sources of revenue and the appropriate levels of assessments in future years, although the Board would establish appropriate budgeting safeguards against allowing the prospects of realizing fine revenue from influencing its rulemaking activities.

- **Municipal Advisors' Share of the Cost of Regulation:** A number of commenters raised concerns about what they referred to as the disproportionate and inequitable cost of regulation borne by dealers, noting that the MSRB recently obtained jurisdiction over municipal advisors and that those advisors should bear not only the entire cost of their own regulation, but also part of the cost of maintaining the MSRB's information systems.[7] One commenter suggests that the MSRB should first assess municipal advisors, beyond the establishment of an initial and annual fee, and only afterwards consider dealer fees.[8]

The MSRB understands the concerns raised by commenters that the fee increases will be used to subsidize municipal advisor regulation. As some commenters noted, however, the MSRB has already taken a first step to assess fees on municipal advisors to account for a portion of the costs of needed regulatory activity, including the establishment for municipal advisors of an initial fee of $100 under Rule A-12 and an annual fee of $500 under Rule A-14.[9] The MSRB expects to assess other fees on municipal advisors as is appropriate.

The fairness of assessments on all classes of regulated entities is to be viewed on a long-term basis and not within a narrow window of time or on a per-rule basis. The rulemaking and related activities that the MSRB must undertake to fulfill its expanded statutory mission are not likely to result in consistently compartmentalized rules and information system that segregate rulemaking with regard to dealer activities from rulemaking relating to municipal advisory activities, or rulemaking to protect investors from rulemaking to protect municipal entities and obligated persons. By and large, the MSRB can be expected to establish rules and information systems that seek to reflect the inter-related nature of the various market participants in a manner that would militate against a process of developing a clear allocation of rulemaking, systems development and operational activities between dealer rulemaking and municipal advisor

7 BDA, Coastal Securities, HTD, MSSB, RW Smith and SIFMA.

8 RW Smith.

9 *See* Exchange Act Release No. 63313 (File No. SR-MSRB-2010-14) (November 12, 2010).

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rulemaking. Further, the Board does not believe that objective and comprehensive rulemaking can appropriately be reduced to a fee-per-rule formulation. Rather, the MSRB firmly believes that it must be adequately funded to undertake all necessary rulemaking in the service of protecting investors, municipal entities, obligated persons and the public interest with rules applicable to dealers, municipal advisors or both without the constraint of determining whether such rulemaking bears a close relationship to the level of funding obtained from each constituency at a particular point in time. Although one constituency may, for a time, partially "subsidize" the rulemaking activities relating to the other constituency, the MSRB believes, and the Dodd-Frank Act mandates, that both constituencies ultimately bear the costs of the MSRB's regulatory activities, and the MSRB expects to continuously review its fee structure to ensure that, over the long-run, there is a reasonable relationship between the amounts assessed to a specific constituency and the level of rulemaking, system development and operational activities undertaken by the MSRB in connection with such constituency, to the extent consistent with the Dodd-Frank Act.

- **Affect on Retail Dealers, Retail Clients, Brokers' Brokers and Issuers:** Many of the commenters complained that the burden of the proposed rule change and, in particular, the technology fee, will be borne disproportionately by retail firms and their customers since the technology fee of $1 applies to all sales transactions, regardless of size.[10] One commenter estimated that retail trades of $25,000 would represent an increase of 900% over the current assessment rate,[11] while another commenter stated that its total MSRB fees for orders it processes for its clients would increase by over 11,000% per month.[12] One commenter noted that the proposed rule change, if approved, would mean a fundamental shift in the cost of operating the MSRB from being primarily borne by primary market participants to secondary market participants.[13] Two commenters stated that broker's brokers would be disproportionately affected because their activities typically involve a large number of retail-sized transactions.[14] Another commenter stated that affiliate-to-affiliate transfers used to fill

10 BDA, Coastal Securities, Edward Jones, MSSB, SIFMA, Southwest Securities and TD Ameritrade.

11 SIFMA. *See also* Edward Jones.

12 TD Ameritrade.

13 HTD.

14 HTD and RW Smith. These commenters also suggest that transactions routed through broker's brokers tend to involve a chain of two or more sales transactions that would result in multiple assessments on the various professionals involved in moving bonds from one investor to another.

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some customer orders would result in duplicative assessments.[15] One commenter suggested further raising the existing transaction fee or basing the technology fee on par value as potential alternatives to the $1.00 per transaction assessment included in the proposed rule change.[16] Another commenter urged the MSRB to ensure that fees assessed on dealers are not to be passed, directly or indirectly, to issuers, stating that some issuers see MSRB fees as line items on their transactions.[17]

The MSRB specifically intended that the proposed rule change would, based on existing transaction and underwriting levels, shift the source of its dealer-based revenues toward market participants engaged in sales and trading of municipal securities. As among dealers, the MSRB views this shift as broadening the universe of dealers that share the burden of funding MSRB activities since the underwriting fee is assessed against a significantly narrower group of dealers – that is, those that act as underwriters of new issues – than the group of dealers that engage in sales and trading of municipal securities, which includes firms active in both the secondary and primary market. Underwriters nonetheless will continue to fund a significant portion of the MSRB's budget.

With regard to the transaction-based assessments, the MSRB believes that the combination of increasing the existing transaction fee based on par value of trades and imposing the new technology fee on individual transactions, regardless of trade size, provides for a mix of assessment measurements that in general further reduces the MSRB's reliance on a circumscribed group of regulated entities for the bulk of its revenues. While the proposed technology fee would, as a percentage of the entire transaction, be larger for retail-size transactions, the MSRB observes that the large percentage increases for small transactions noted by some commenters, if assumed to be accurate, fail to take into account that, under the current formula based solely on trade size, the actual amount of the assessment is extremely small and will continue to be small and likely would have only a negligible effect on overall transaction costs for retail investors even after such increases. Further, every transaction, regardless of size, draws equally on MSRB information systems and, therefore, it is appropriate that at least a portion of the MSRB's revenues reflect this universal usage of such resources.

All fees assessed by the MSRB are reviewed by the Board on an on-going basis to ensure that they continue to be appropriately assessed, meet the resource needs of the MSRB, and are appropriate from the standpoint of the fair allocation of burdens for supporting MSRB activities.

15 MSSB.

16 Edward Jones.

17 GFOA.

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By indicating in the rule filing that the technology fee is viewed as transitional, the Board has committed itself to review, in particular, the necessity for the technology fee on an on-going basis, including whether the technology fee should continue to be assessed and, if so, at what level. Such review would take into consideration, among other things, whether there is a continuing need for ensuring proper funding of capital expenditures and a technology renewal fund, the other sources of revenue then available to it, issues of equity among regulated entities and any potential impact on retail investors.

Concerns expressed by certain commenters regarding the imposition of transaction-based assessments on situations where multiple separate transactions may occur to effect a movement of a position in a security are reflective of the existing structure of the transaction assessment and do not arise anew as a result of the proposed rule change. In fact, the rule proposal is more equitable to market participants in that the transaction fee exemptions that apply to short-term securities would not apply to the technology fee, thereby broadening the base on which such fee is assessed. It is true that a necessary corollary to shifting the cost burden more towards the broader sales and trading market, and thus becoming less reliant on underwriting assessments, is that firms engaging solely or primarily in sales and trading activities, and not in underwriting activities, may view this shift as having a greater affect on such firms than on others. However, the MSRB believes that any such shift is appropriate.

Finally, Rule A-13(e) provides that no dealer shall charge or otherwise pass through the fee required under the rule to an issuer of municipal securities. This provision would most logically apply to the underwriting assessment imposed under such rule, which is not the subject of the current rule filing. Nonetheless, if any issuer of municipal securities believes that a dealer is violating this rule provision, the MSRB urges such issuer to contact the appropriate enforcement agency with any relevant information regarding such potential rule violation.

- **Use of MSRB's Existing Surplus:** Some commenters argued that the MSRB has an excessively large surplus that should be utilized to fund projects, regulation, and technology renewal prior to implementation of any fee increases.[18] Two commenters suggested that non-profit organizations only need 25% or three months of reserve to cover expenses.[19]

The MSRB maintains cash and liquid reserves as are prudent for a regulatory organization that maintains market information transparency systems that are as central to the marketplace and to the protection of investors, municipal entities, obligated persons and the

[18] HTD, RW Smith, SIFMA and Southwest Securities.

[19] RW Smith and SIFMA.

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public interest. It is illogical to compare the MSRB with a charity or other non-profit organization in terms of the appropriate level of reserves. Other non-profit organizations active in the municipal securities market as well as other self-regulatory organizations have reserves of comparable relative size. In any event, the MSRB's cash and liquid reserves are projected to decrease significantly over the next three years, if additional funding is not approved and underwriting and transaction activity remains level. Further, if underwriting volume were to decrease significantly – which can happen from time to time due to market conditions or change in federal law – reserves could be depleted on an accelerated basis. Thus, it would be imprudent to maintain reserves at levels comparable to those suggested by commenters.

- **MSRB Fees Should be Based on Municipal Securities Activities of Regulated Entities:** Finally, two commenters recommended that the MSRB consider an entirely new revenue model, where firms are assessed based on their gross income from municipal securities activities, including underwriting, trading, sales, and advisory services.[20] However, one commenter opposed such a change at this time, noting that there is not industry consensus for this approach and further analysis would be needed.[21]

Without taking a position with regard to whether, in the long term, a shift to a revenue-based assessment system should be adopted by the MSRB, any such change could not realistically be effected in a sufficiently timely manner to ensure that the MSRB could continue to operate effectively given its current resource base and operational commitments, as well as its statutory mandate. Unlike FINRA, which has jurisdiction over its members that encompasses (with limited exceptions) their entire scope of activities, the MSRB's regulatory jurisdiction is limited to the areas specified in Section 15B of the Exchange Act, which in many cases consists of a subset of a firm's overall activities. Thus, in imposing its revenue-based assessment, FINRA does not face some of the same constraints and need for clearly defining the extent of activities subject to such an assessment as would the MSRB.

For dealers, sales and trading transactions and underwriting activities are the key types of activities from which they derive revenues that are clearly tied to the MSRB's statutory mandate. The other type of activity undertaken by municipal advisors (including dealers acting as municipal advisors) that is clearly tied to the MSRB's statutory mandate is, of course, municipal advisory activities, for which the MSRB has not yet established an appropriate assessment methodology but which the MSRB acknowledges is something it must focus on in the near future. These three types of activities would, therefore, encompass the vast majority of the

20 HTD and SIFMA.

21 MSSB.

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activities of dealers and municipal advisors that would generate the revenues on which the MSRB would impose its assessments under a revenue-based assessment system. Therefore, assessments based on the MSRB's current model, together with an appropriate assessment to be developed on municipal advisory activities, serve as a reasonable approximation of the type of assessments that would ultimately be imposed under a revenue-based system.

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After reviewing all of the comments, the MSRB believes that the Commission should approve the proposed rule change as filed by the MSRB. 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: Martha Mahan Haines, Chief,
Office of Municipal Securities, SEC

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