

November 9, 2010

Elizabeth M. Murphy, Secretary  
U.S. Securities and Exchange Commission  
100 F. Street, NE  
Washington, DC 20549-1090

**Re: File Number SR-MSRB-2010-10: Municipal Securities Rulemaking Board Proposed Fee Increases**

Dear Ms. Murphy:

Hartfield, Titus & Donnelly, LLC (“Hartfield”) appreciates this opportunity to submit comments on the Securities and Exchange Commission’s (“SEC”) Release No. 34-63095, the Municipal Securities Rulemaking Board’s (“MSRB”) “Notice of Filing of Proposed Rule Change Consisting 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” (the “Notice”).

While Hartfield supports effective and efficient regulation of the municipal securities markets, and realizes that the MSRB must have resources sufficient to allow it to meet its important obligations, we do not believe that the proposed fee increases are reasonable in size or in allocation, and we urge the SEC to reject them. We believe that the MSRB should adopt a fee structure that is based on the municipal securities activities of each market participant, to more accurately reflect “the extent of its municipal securities activities.”<sup>1</sup> We further believe that the MSRB should be required to conduct an open, transparent, long-range budgeting process, including an analysis of how the MSRB sets fees to allocate the cost of funding the MSRB among its members, before fee increases such as these should be considered by the SEC.

The MSRB’s proposal would amend MSRB Rule A-13 in two ways. First, the transactional fee, currently .0005% of the total par value of inter-dealer and customer sales that are reported to the MSRB (the “Transaction Fee”) would be doubled to .001% of the total par value on those transactions. Second, a new fee would be established (the “Technology Fee”) which would impose a \$1.00 per transaction fee on inter-dealer and customer sales that are reported to the MSRB.<sup>2</sup> The effective date of the increased fees

<sup>1</sup> MSRB Notice 2000-17, Revision to Board Fee Assessments: Rule A-13 (Apr. 27, 2000). *See also* MSRB Reports, Revisions to Board Fee Assessments: Rules A-13, A-14, and G-14 (Vol. 16 No. 2 June 1996); MSRB Reports, Fee Assessment For Dealers: Rules A-13, A-14, and G-14 (Vol. 15 No. 3 Oct. 1995) [hereinafter MSRB Fee Assessment Notices].

<sup>2</sup> We note that the MSRB does not propose to change the fee levied on underwritings, which is \$.03 per \$1,000 of municipal securities purchased in a primary offering (with certain specified exceptions) (the “Underwriting Fee”).

would be January 1, 2011. The MSRB states that the purpose of the rule change is to “assess reasonable fees necessary to defray the costs and expenses of operating and administering the MSRB.” We believe that the proposed fee increases greatly exceed their stated purpose. We find it hard to believe that the MSRB’s expenses will almost double in one year. We believe it would be much more reasonable for the MSRB to adjust its fees on a gradual basis, in response to budgeted expenses.

### **Magnitude of Proposed Fee Increases**

The MSRB states in the Notice that revenue in 2009 was \$19.6 million, down from \$22.2 million in 2008. It further states that the revenue expected to be generated by the fee increases are \$17 million annually, comprised of \$7 million from the Transaction Fee and \$10 million from the Technology Fee. The revenue expected to be generated by these fees amounts to an increase of over 75% of 2008 revenue, and an increase of over 85% of 2009 revenue. The magnitude of these fee increases does not appear to be justified by the MSRB’s stated rationale, which are as follows: (1) expenses for ongoing operations are increasing; (2) anticipated expenses related to new regulatory responsibilities under the Dodd-Frank Act<sup>3</sup>; and (3) replacement of aging and outdated information technology hardware and software.

MSRB does not provide any information regarding the expected cost of any of the three rationale, and we believe that they should do so prior to the approval of any fee increase. For example, what are the on-going operational expenses that are increasing? Are these expenses of the nature that the MSRB should be controlling them, as opposed to passing them through to municipal securities dealers, and ultimately (to some degree), on to investors? In the current economic climate, we do not believe that any organization should simply feel free to incur additional operating expenses without demonstrating that they have taken every reasonable step to contain those costs.

We also believe that the MSRB should provide information regarding the nature of the increased expenditures for Dodd-Frank Act responsibilities, and to justify why dealers should bear some or all of these costs, as opposed to the new parties that will be regulated by MSRB under the Dodd-Frank Act, such as municipal advisors. We note that the MSRB has stated that they plan to assess initial and annual fees to “help defray a portion of the costs associated” with these activities.<sup>4</sup> We believe that the MSRB should have municipal securities advisors bear *all* the costs of their regulation, and that any initial costs associated with this new activity be paid out of the MSRB’s reserve fund, to be recouped by the reserve fund through the municipal adviser fees.

Lastly, the MSRB has offered no information regarding the expected magnitude of its planned technology upgrade. While the Technology Fee is described as “transitional,” we believe that MSRB should be required to set forth its expected technology capital budget so that the meaning of “transitional” could be better understood. We believe this to be especially important because all of the technology initiatives mentioned in the Notice are programs which were designed, developed, equipped and implemented in the past “using general revenue and cash reserves.” If these programs, including the Electronic Municipal Market Access and Short-term Obligation Rate Transparency systems were implemented using general revenues and cash reserves, MSRB should clearly explain the nature and scope of these future projects that require funding equal to 50% of last year’s revenue, or \$10 million.

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<sup>3</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010).

<sup>4</sup> Municipal Securities Rulemaking Board, “Municipal Securities Rulemaking Board Holds Quarterly Board Meeting,” Press Release, October 25, 2010.

Given that the proposed fee increases would equal between 75% to 85% of the MSRB's annual revenue for the last two years, we believe that MSRB should be required to provide significantly more information, in a manner that allows dialogue with its members, before any fee increases is approved.

### **Allocation of MSRB Fees**

The increase in the Transaction Fee, and the imposition of the Technology Fee would substantially shift the burden of funding MSRB from underwriting fees to secondary market fees. Based on the information provided by MSRB, in 2009 underwriting fees accounted for approximately 55% of revenue, and the Transaction Fee accounted for 36% of revenue. If 2009 revenue sources are held constant, and the fee increases are added to revenue at the amounts projected by MSRB, our rough analysis indicates that underwriting fees would fall to roughly 40% of the MSRB's budget, and secondary market fees would climb to just over 55% of *greatly expanded revenue*. MSRB offers no rationale for substantially increasing the burden on secondary market transaction fees while leaving underwriting fees at current levels.<sup>5</sup>

Our concern regarding the imposition of greater costs on the secondary market is informed by our business as a municipal securities broker's broker. As broker's brokers, our business is to provide liquidity in the secondary market of municipal securities, which are inherently illiquid, due to the large number of municipal securities outstanding, the limited number of secondary market purchasers, and the limited amount of information available on outstanding issues.<sup>6</sup> Broker's brokers also trade for significantly smaller commissions than do retail broker-dealers, so these increases would have a disproportionate impact on municipal securities broker's brokers. For example, an analysis of our trading with dealers has demonstrated to us that on average, retail dealers earn roughly *five* times what we do, on a customer - secondary market - customer transaction basis (i.e., when securities are bought by a dealer from a customer, sold through a broker's broker to another dealer, that sells them to a customer).

The proposed fee increases would therefore unreasonably raise costs on the small universe of less than 15 dedicated municipal securities broker's brokers, which may further impede liquidity in the secondary market for municipal securities. For example, if the fee increases were to be adopted as proposed, Hartfield's annual payments to the MSRB would **increase by roughly 150%**. Thus, next year our fees to the MSRB will be 2 and 1/2 times greater than this year. Given that MSRB's revenue is expected to increase by roughly 80%, the fact that Hartfield's payments will increase by almost twice that amount clearly demonstrates that these fee increases are being unevenly allocated among the different parts of the municipal securities industry. In addition to the inequitable allocation of these new fees, Hartfield and similarly situated municipal securities dealers would bear the additional burden of having less than two months to prepare for this greatly increased regulatory expense.

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<sup>5</sup> We note that although transaction assessments have not changed in 10 years, underwriting assessments (despite the elimination of certain exemptions), have not been increased in 18 years.

<sup>6</sup> See SEC Report on Transactions in Municipal Securities (July 1, 2004), available at: <http://www.sec.gov/news/studies/munireport2004.pdf>. The report found that during the study period, about 70% of municipal securities did not trade, and less than 1% of securities accounted for half of the transaction activity.

## **Revenue-Based Funding**

We believe that the disparate impact of the fee increases described above should lead to a reassessment of how the MSRB levies fees to fund its operations. As a practical matter, the continuance of adopting or modifying existing fees that do not apply evenly to all participants in the municipal securities market is likely to result in one or more groups bearing a disproportionate burden. In light of this, we believe that, in connection with its review of the magnitude of these fees, the MSRB should also review the manner in which it allocates fees.

The MSRB has consistently stated its intention that the fees it levies on “each dealer reflect the extent of its municipal securities activities.”<sup>7</sup> As described above, the imposition of the increase in the Transaction Fee and the imposition of the Technology Fee, along with leaving the Underwriting Fee unchanged, results in a substantial shift in funding the MSRB from the primary to the secondary market. The MSRB offers no rationale to support this shift, and no evidence to support that such a shift is consistent with its goal of allocation of costs in proportion to municipal securities activities.

We believe that, in order to allocate its fees in a manner consistent with the MSRB’s stated goal, it should transition away from fees on specific market activities to a fee model based on the *revenue* that any municipal securities dealer derives from its municipal securities activities. Such a model would allow every MSRB member to know that any proposed fee increase in the future would not carry with it a disparate impact. This would allow a simpler analysis of the proposed fee increase and whether the increase is warranted.

We believe that such a fee structure also would be organizationally efficient for the MSRB to administer. Schedule I of each broker-dealer’s fiscal year end FOCUS Report requires reporting annual municipal income, and this should be used as the basis for determining fees due to the MSRB. The information in Schedule I of the FOCUS Reports is audited as part of each firm’s SEC Rule 17a-5 annual report, and therefore is sufficiently reliable to use for assessing fees on MSRB members. In addition to permitting more equitable allocation of fees, the operational infrastructure required to track and calculate fees using this method would be significantly less complex and less costly than the current multi-revenue stream method employed by the MSRB for allocating fees.

## **Transparency in Budgeting**

The fee increases proposed in the Notice represent the largest expansion of the MSRB’s resources since the MSRB was established in 1975. In light of this fact, we would have expected that the MSRB engage in a dialogue with its relevant constituencies. However, the MSRB chose not to engage in any dialogue, and simply filed its request with the SEC, allowing only 21 days for comments and less than 3 months before the substantial fee increases go into effect. Given the magnitude of their request, the MSRB should allow reasonable time for consideration and dialogue.

We believe that the MSRB should be required to engage in an open process with its members to discuss at least the following issues: (1) the future revenue the MSRB believes it needs; (2) the projects the it intends to pursue with its proposed additional revenue; and (3) the best and fairest way to allocate the MSRB’s costs across the industry. We believe that the MSRB should be required to conduct such a dialogue before the SEC considers its proposed fee increases.

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<sup>7</sup> MSRB Fee Assessment Notices, *supra* note 1.

We also have a separate, but related, concern regarding the MSRB's concept of a pre-funded, apparently unbudgeted, technology renewal fund. MSRB provides no long-range plan for its proposed technology renewal project. In fact, it is unclear from the proposal whether any meaningful long-term planning has been done. The idea that such a fund will be funded by an open end "transitional" fee of roughly \$10 million per year, an amount that is over half of the preceding year's *entire* revenue, appears excessive, in the absence of compelling information supporting such a need.

**Conclusion**

For the reasons set forth above, we believe that the proposed fee increases should not be approved, and that the MSRB should equitably allocate its fees among participants in the municipal securities market by basing them on the revenue derived from each participant's municipal securities activities, to more accurately reflect the "extent of its municipal securities activities."

We thank you again for the opportunity to comment on this important matter.

Very truly yours,



John J. Lynch  
Executive Vice President