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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-84630; File No. SR-MSRB-2018-07]

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Granting Approval of a Proposed Rule Change to Amend MSRB Rule G-3, on Professional Qualification Requirements, to Require Municipal Advisor Principals to Become Appropriately Qualified by Passing the Municipal Advisor Principal Qualification Examination

November 20, 2018.

I. Introduction

On September 19, 2018, the Municipal Securities Rulemaking Board (the “MSRB” or “Board”) filed with the Securities and Exchange Commission (the “SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule to amend Rule G-3, on professional qualification requirements, to (i) require persons who meet the definition of a municipal advisor principal, as defined under Rule G-3(e)(i), to pass the Municipal Advisor Principal Qualification Examination (“Series 54 examination”) in order to become appropriately qualified as a municipal advisor principal; (ii) specify that such persons who cease to be associated with a municipal advisor for two or more years at any time after having qualified as a municipal advisor principal must requalify by examination unless a waiver is granted; (iii) add the Series 54 examination to the list of qualification examinations for which a waiver can be sought; (iv) provide that municipal advisor

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR § 240.19b-4.

representatives may function as a principal for 120 calendar days without being qualified with the Series 54 examination; and (v) make a technical amendment to Rule G-3(e) to clarify that a municipal advisor principal must pass the Municipal Advisor Representative Qualification Examination (“Series 50 examination”) as a prerequisite to becoming qualified as a municipal advisor principal (collectively the “proposed rule change”). The MSRB requested that the proposed rule change become effective 30 days from the date of SEC approval. The proposed rule change was published for comment in the Federal Register on October 9, 2018.³

The Commission received one comment letter on the proposed rule change.⁴ On November 16, 2018, the MSRB responded to the comments received by the Commission.⁵

II. Description of Proposed Rule Change

The proposed rule change would adopt MSRB Rule G-3(e)(ii)(A) to establish additional qualification requirements for municipal advisor principals. Specifically, the proposed rule change would require those who meet the definition of a municipal advisor principal, as defined under MSRB Rule G-3(e)(i), (i.e., persons engaged in the management, direction or supervision of the municipal advisory activities of the municipal advisor and its associated persons) to pass both the Series 50 examination and Series 54 examination prior to becoming qualified as a municipal advisor principal. Additionally, the proposed amendments to MSRB Rule G-3(e)(ii)

³ Securities Exchange Act Release No. 84341 (October 2, 2018) (the “Notice of Filing”), 83 FR 50708 (October 9, 2018).

⁴ See Letter to Gail Marshall, Chief Compliance Officer, Municipal Securities Rulemaking Board, from Elaine M. Philbrick, Principal, Derivative Advisors, dated October 23, 2018 (the “Derivative Advisors Letter”). This letter was delivered to the MSRB, who then filed the letter with the Commission.

⁵ See Letter to Secretary, Commission, from Gail Marshall, Chief Compliance Officer, MSRB, dated November 16, 2018 (the “MSRB Response Letter”), available at <https://www.sec.gov/comments/sr-msrb-2018-07/srmsrb201807-4654464-176503.pdf>.

would also prescribe that the passing score shall be determined by the Board. The MSRB stated that the establishment of qualification requirements for municipal advisor principals would assist in ensuring that such persons have a specified level of competency that is appropriate in the public interest and for the protection of investors, and municipal entities and obligated persons.⁶ Additionally, the MSRB stated that the establishment of the Series 54 examination is consistent with the intent of the establishment of the Series 50 examination “to mitigate problems associated with advice provided by those individuals without adequate training or qualifications,” in that municipal advisor principals should be appropriately qualified to supervise such activities of municipal advisor representatives.⁷

Proposed MSRB Rule G-3(e)(ii)(B) would require any person qualified as a municipal advisor principal who ceases to be associated with a municipal advisor for two or more years at any time after having qualified as a municipal advisor principal to requalify by examination by passing both the Series 50 examination and Series 54 examination prior to becoming qualified as a municipal advisor principal, unless a waiver is granted pursuant to MSRB Rule G-3(h)(ii), on waiver of qualification requirements.⁸ The MSRB also proposed to amend MSRB Rule G-3(h)(ii) and Supplementary Material .02 to provide that the MSRB will consider waiving the qualification requirements of a municipal advisor principal in extraordinary cases where the applicant was previously qualified as a municipal advisor principal by passing both the Series 50 examination and Series 54 examination and the person’s qualification lapsed. The MSRB stated

⁶ See Notice of Filing.

⁷ Id.

⁸ The Board stated that it will review waiver requests on their individual merits, taking into consideration relevant facts presented by an applicant. See Notice of Filing.

that Proposed Rule G-3(e)(ii)(C) would allow a municipal advisor principal to be designated a municipal advisor principal and to function in that capacity for a period of 120 calendar days without having passed the Series 54 examination.⁹ The MSRB noted that on June 8, 2018, the MSRB filed a proposed rule change with the SEC for immediate effectiveness, which, in part, extended the period from 90 calendar days to 120 calendar days for municipal securities representatives to function in a principal capacity without passing a principal examination as long as the municipal securities representative has at least 18 months of experience within the five-year period immediately preceding the designation as a principal.¹⁰ The MSRB stated that it is not extending this experience requirement to a municipal advisor representative in order to function as a municipal advisor principal for 120 calendar days because, given the typical size of a municipal advisor firm, coupled with the newness of the qualification classifications and development of professional qualification requirements for municipal advisor professionals, such a requirement could pose an undue burden on a municipal advisor's operational needs.¹¹

The MSRB proposed a technical amendment to Rule G-3(e)(i), on definitions, to establish as a separate rule provision, and to clarify, that qualification as a municipal advisor representative is a prerequisite to obtaining qualification as a municipal advisor principal.¹² The MSRB is also proposing a technical amendment to renumber the rule provisions under Rule G-3(e).

⁹ See Notice of Filing.

¹⁰ Id.

¹¹ Id.

¹² Id.

The MSRB stated that it believes that professional qualification examinations, such as the Series 50 examination and Series 54 examination, are established means for determining the competency of individuals in a particular qualification classification.¹³ The MSRB stated that it has, in consultation with the MSRB's Professional Qualification Advisory Committee, developed the Series 54 examination to ensure that a person seeking to qualify as a municipal advisor principal satisfies a specified level of competency and knowledge by measuring a candidate's ability to apply the applicable federal securities laws, including MSRB rules to the municipal advisory activities of a municipal advisor.¹⁴ The MSRB stated that it has adhered to recognized test development standards by performing a job study to determine the appropriate topics to be covered and weighting of such topics on the Series 54 examination.¹⁵ The MSRB noted that from October 17, 2017 through November 7, 2017, it conducted a job study of municipal advisor principals via a web-based survey.¹⁶ The MSRB stated that the job study was sent to the primary and optional regulatory contacts at over 500 municipal advisors, representing every municipal advisor with at least one person qualified with the Series 50 examination. The MSRB stated that it received 212 responses to the job study, representing data from municipal advisor principals from different-sized municipal advisors in different areas of the country.¹⁷

¹³ See Notice of Filing.

¹⁴ Id.

¹⁵ Id.

¹⁶ Id.

¹⁷ Id.

In the Notice of Filing, MSRB stated that it will announce the effective date of the permanent Series 54 examination at a later date in an MSRB Notice published on MSRB.org.¹⁸ The MSRB stated that the effective date of the Series 54 examination will be the date the Series 54 examination becomes permanently available.¹⁹ However, the MSRB stated that in advance of the permanent version of the Series 54 examination, the MSRB anticipates conducting a pilot of the Series 54 examination, the results of which will be used to determine the passing score for the permanent Series 54 examination.²⁰ The MSRB also stated that prior to the launch of the pilot version of the Series 54 examination, it will file a content outline with the SEC describing: the topics on the examination; the percentage of the examination devoted to each topic area; and the number of questions that will appear on the examination.²¹ In the Notice of Filing, the MSRB stated that the content outline will also contain sample examination questions and a list of reference materials to assist individuals in preparation for the examination.²² The MSRB stated that to provide persons who function as municipal advisor principals with sufficient time to satisfy the new qualification requirement, consistent with the implementation process for the Series 50 examination, the MSRB is proposing a one-year grace period from the effective date of the Series 54 examination for such persons to pass the examination and become appropriately qualified as municipal advisor principals.²³ According to the MSRB, during this one-year grace

¹⁸ Id.

¹⁹ Id.

²⁰ Id.

²¹ Id.

²² Id.

²³ Id.

period, a person functioning as a municipal advisor principal would be permitted to continue to engage in the management, direction or supervision of the municipal advisory activities of the municipal advisor and its associated persons so long as such person is qualified with the Series 50 examination.²⁴ The MSRB stated that this one-year grace period is designed to ensure that those persons functioning as a municipal advisor principal can prepare for and pass the Series 54 examination without causing considerable disruption to the business of the municipal advisor.²⁵ The MSRB also stated that after the one-year grace period, a municipal advisor representative would only be permitted to function in the capacity of a municipal advisor principal, after being so designated, for a period of 120 days without being a qualified municipal advisor principal.²⁶

The MSRB requested in the Notice of Filing that the proposed rule change become effective 30 days from the date of SEC approval.²⁷

III. Summary of Comments Received and MSRB's Responses to Comments

As noted previously, the Commission received one comment letter on the proposed rule change, as well as the MSRB Response Letter. The commenter, Derivative Advisors (“Derivative Advisors”), stated that it is an interest rate swap broker who is a registered municipal advisor. The commenter believes that a firm that is principally an interest rate swap broker that is also registered as a municipal advisor should not have to take a qualification

²⁴ Id.

²⁵ Id.

²⁶ Id.

²⁷ Id.

examination that is not specifically targeted to their business model.²⁸ The commenter suggested that only 5% of the questions on the Series 50 examination were related to swaps, and the rest had nothing to do with the firm's services.²⁹ The commenter also stated that "the proposed amendment to Rule G-3 requires yet an additional exam that is completely unrelated to our firm," and that in order to pass the Series 54 examination, each principal will need to spend hundreds of hours to learn and master unfamiliar new material that does not serve the firm's customers or business.³⁰ The commenter also suggested that it may consider exiting the business of advising municipalities due to the investment of time and effort required by the proposed rule change.³¹ Lastly, the commenter stated that requiring the Series 54 examination for municipal advisors that are strictly swap brokers is not in the public interest and does not benefit investors, municipal entities or obligated persons. Therefore the commenter believes that swap brokers should be exempt from the proposed requirement that each municipal advisor principal take and pass the Series 54 examination.³²

²⁸ See Derivative Advisors Letter.

²⁹ Id.

³⁰ Id.

³¹ Id.

³² Id.

The MSRB responded by stating that the MSRB is charged with setting professional qualification standards for municipal advisors under Section 15B(b)(2)(A)³³ of the Act.³⁴ The MSRB stated that it believes that the establishment of the Series 54 examination is consistent with the intent of the establishment of the Series 50 examination to mitigate problems associated with advice by those individuals without adequate training or qualification, in that municipal advisor principals should be appropriately qualified to supervise such activities of municipal advisor representatives.³⁵ The MSRB also stated that the creation of a principal-level examination furthers the stated objective of Section 15B(b)(2)(C)³⁶ of the Act to foster the prevention of fraudulent practices by enhancing the overall professional qualification standards of municipal advisor principals – recognizing that proper supervision of a municipal advisor’s activities and that of its associated persons play a role in the protection of the municipal securities market.³⁷

In further response to the Derivative Advisors Letter, the MSRB stated that it believes that a municipal advisor principal should demonstrate knowledge of the rules and regulations governing municipal advisors.³⁸ The MSRB noted that as a principal qualification examination, the Series 54 examination is designed to measure a candidate’s knowledge of the regulatory requirements under the federal securities laws, including MSRB rules, applicable to municipal

³³ 15 U.S.C. 78o-4(b)(2)(A).

³⁴ See MSRB Response Letter.

³⁵ Id.

³⁶ 15 U.S.C. 78o-4(b)(2)(C).

³⁷ See MSRB Response Letter.

³⁸ Id.

advisors.³⁹ The MSRB stated that these rules and regulations generally apply to all municipal advisors and the range of activities that a municipal advisor is permitted to engage in, regardless of the niche business a municipal advisor firm may opt to engage in.⁴⁰ The MSRB further noted that all municipal advisors are required to adhere to the federal securities laws, including the MSRB rules applicable to municipal advisors, including, but not limited to, those governing the registration requirements, recordkeeping requirements and pay-to-play prohibitions.⁴¹ Accordingly, the MSRB stated that it does not believe it is prudent to establish an exemption from the qualification requirements for those municipal advisors that opt to limit the scope of their municipal advisory activities.⁴²

Furthermore, the MSRB stated that it does not believe that the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.⁴³ The MSRB stated that it considered whether it is possible that the costs associated with preparing for and taking the Series 54 examination, relative to the baseline of no principal-level examination, may affect the competitive landscape by leading some municipal advisors to exit the market rather than incur the burden of meeting the qualification requirements.⁴⁴ The MSRB stated that it recognizes that meeting professional qualification requirements results in municipal advisors incurring programmatic costs, including costs to

³⁹ Id.

⁴⁰ Id.

⁴¹ Id.

⁴² Id.

⁴³ Id.

⁴⁴ Id.

study for and take the applicable examinations. The MSRB also stated that it believes the benefit of having associated persons of municipal advisors who engage in the management, direction or supervision of the municipal advisory activities of the municipal advisor and its associated persons to demonstrate specified level of competency necessary to supervise municipal advisory activities, outweighs the potential burden imposed.⁴⁵ The MSRB stated that, as noted in the filing, to minimize disruption to a municipal advisor's operation, the MSRB proposed a one-year grace period from the effective date of the Series 54 examination to afford time for associated persons of a municipal advisor who are directly engaged in the management, direction or supervision of the municipal advisory activities of the municipal advisor and its associated persons to take and pass the Series 54 examination and become appropriately qualified as municipal advisor principals.⁴⁶ The MSRB stated that during this one-year grace period, a person functioning as a municipal advisor principal would be permitted to continue to engage in the management, direction or supervision of the municipal advisory activities of the municipal advisor and its associated persons so long as such person is qualified with the Series 50 examination.⁴⁷

IV. Discussion and Commission Findings

The Commission has carefully considered the proposed rule change, the comment letter received, and the MSRB Response Letter. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the MSRB.

⁴⁵ Id.

⁴⁶ Id.

⁴⁷ See Notice of Filing and MSRB Response Letter.

In particular, the proposed rule change is consistent with Sections 15B(b)(2)(A), 15B(b)(2)(C), and 15B(b)(2)(L) of the Act.⁴⁸ Section 15B(b)(2)(A) of the Act provides that the MSRB's rules shall provide that no municipal securities broker or municipal securities dealer shall effect any transaction in, or induce or attempt to induce the purchase or sale of, any municipal security, and no broker, dealer, municipal securities dealer, or municipal advisor shall provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, unless ... such municipal securities broker or municipal securities dealer and every natural person associated with such municipal securities broker or municipal securities dealer meet such standards of training, experience, competence, and such other qualifications as the Board finds necessary or appropriate in the public interest or for the protection of investors and municipal entities or obligated persons.⁴⁹ Section 15B(b)(2)(A) of the Act also provides that, in connection with the definition and application of such standards, the MSRB may appropriately classify municipal advisors and their associated persons, specify that all or any portion of such standards shall be applicable to any such class, and require persons in any such class to pass an examination regarding such standards of competence.⁵⁰ The Commission believes that the proposed rule change is consistent with Section 15B(b)(2)(A) of the Act because the proposed rule change requires individuals who supervise municipal advisory activities to pass a professional qualification examination which is an established means for determining the basic competency of individuals in a particular class. The Commission believes that requiring prospective municipal advisor principals to pass a basic

⁴⁸ 15 U.S.C. 78o-4(b)(2)(A), 78o-4(b)(2)(C), 78o-4(b)(2)(L).

⁴⁹ 15 U.S.C. 78o-4(b)(2)(A).

⁵⁰ Id.

qualification examination will protect investors, municipal entities, and obligated persons by ensuring such principals have a basic understanding of the role of a municipal advisor principal and the rules and regulations governing such individuals.

Section 15B(b)(2)(C) of the Act⁵¹ provides in part that MSRB rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors, municipal entities, obligated persons, and the public interest. The Commission believes that the proposed rule change will bolster the protection of municipal entities and obligated persons who employ municipal advisors to engage in municipal advisory activities on their behalf by helping to ensure that individuals engaged in the management, direction or supervision of the municipal advisory activities of a municipal advisor and its associated persons demonstrate a specified level of competence of the rules and regulations governing such municipal advisory activities. The Commission also believes that the proposed rule change will, through the establishment of professional qualification standards, effectively serve to benefit municipal advisors as such standards for municipal advisor principals are designed to ensure that any person that supervises, manages or directs the municipal advisory activities of a municipal advisor and its associated persons understands the application of the federal securities laws to a municipal advisor's municipal advisory activities in order to safeguard the municipal advisor from conduct that would violate the federal securities laws.

Additionally, Section 15B(b)(2)(L)(iii) of the Act provides that the MSRB's rules shall provide professional standards with respect to municipal advisors.⁵² The Commission believes that the proposed rule change is consistent with Section 15B(b)(2)(L)(iii) of the Act because it

⁵¹ 15 U.S.C. 78o-4(b)(2)(C).

⁵² 15 U.S.C. 78o-4(b)(2)(L)(iii).

would establish professional standards for those individuals supervising municipal advisory activities by requiring such individuals to demonstrate a basic competency regarding the role of municipal advisor principals and the rules and regulations governing the conduct of such persons.

Section 15B(b)(2)(L)(iv) of the Act requires that MSRB rules not impose a regulatory burden on small municipal advisors that is not necessary or appropriate in the public interest and for the protection of investors, municipal entities, and obligated persons, provided that there is robust protection of investors against fraud.⁵³ The Commission believes that the proposed rule change is consistent with Section 15B(b)(2)(L)(iv) of the Act. While the proposed rule change would affect all municipal advisors, including small municipal advisors, it is a necessary and appropriate regulatory burden in order to establish the baseline competence of those supervising individuals engaged in municipal advisory activities. Establishing a baseline competence standard is necessary for the protection of investors, municipal entities, and obligated persons. The Commission also believes such baseline competence standard is in the public interest because it promotes compliance with the rules and regulations governing the conduct of municipal advisors.

In approving the proposed rule change, the Commission has considered the proposed rule change's impact on efficiency, competition, and capital formation.⁵⁴ Section 15B(b)(2)(C) of the Act⁵⁵ requires that MSRB rules not be designed to impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The Commission does not

⁵³ 15 U.S.C. 78o-4(b)(2)(L)(iv).

⁵⁴ 15 U.S.C. 78c(f).

⁵⁵ 15 U.S.C. 78o-4(b)(2)(C).

believe that the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act since it would apply equally to all municipal advisor principals who supervise municipal advisory activities. Furthermore, the Commission believes that the potential burdens created by the proposed rule change are to be likely outweighed by the benefits of establishing baseline professional qualification standards and promoting compliance with the rules and regulations governing the conduct of municipal advisors. The Commission has reviewed the record for the proposed rule change and notes that the record does not contain any information to indicate that the proposed rule change would have a negative effect on capital formation. The Commission believes that the proposed rule change includes accommodations that help promote efficiency. Specifically, the MSRB has provided a one-year grace period for passing the examination. As noted by the MSRB, the grace period provides municipal advisor principals with sufficient time to study and take the examination without causing an undue disruption to the business of the municipal advisor.

As noted above, the Commission received one comment letter on the proposed rule change. The Commission believes that the MSRB considered carefully and responded adequately to the comments and concerns regarding the proposed rule change. For the reasons noted above, the Commission believes that the proposed rule change is consistent with the Act.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁵⁶ that the proposed rule change (SR-MSRB-2018-07) be, and hereby is, approved .

For the Commission, pursuant to delegated authority.⁵⁷

Eduardo A. Aleman,

Assistant Secretary.

⁵⁶ 15 U.S.C. 78s(b)(2).

⁵⁷ 17 CFR 200.30-3(a)(12).

