

2014-04

**Publication Date**

February 25, 2014

**Stakeholders**

Municipal Advisors,  
Issuers, General  
Public

**Notice Type**

Request for  
Comment

**Comment Deadline**

April 28, 2014

**Category**

Fair Practice

**Affected Rules**

[Rule G-8](#); [Rule G-9](#)

## Request for Comment on Draft MSRB Rule G-44, on Supervisory and Compliance Obligations of Municipal Advisors

### Overview

The Municipal Securities Rulemaking Board (MSRB) is seeking comment on draft MSRB Rule G-44 on supervisory and compliance obligations of municipal advisors when engaging in municipal advisory activities. The MSRB is also seeking comment on associated draft amendments to existing MSRB Rules G-8, on books and records, and G-9, on the preservation of records.

Comments should be submitted no later than April 28, 2014, and may be submitted in electronic or paper form. Comments may be submitted electronically by clicking [here](#). Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314. All comments will be available for public inspection on the MSRB's website.<sup>1</sup>

Questions about this notice should be directed to Michael L. Post, Deputy General Counsel, or Darlene Brown, Assistant General Counsel, at 703-797-6600.

### Background

The MSRB is currently developing a regulatory framework for municipal advisors. A significant aspect of that regulatory framework is draft Rule G-44 establishing supervisory and compliance obligations of municipal advisors when engaging in municipal advisory activities. Draft Rule G-44 embodies a primarily principles-based approach to supervision to, among other things,

<sup>1</sup> Comments are posted on the MSRB website without change. Personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.

accommodate the diversity of the municipal advisor population, including small and single-person municipal advisors. Draft Rule G-44 is accompanied by draft amendments to Rules G-8 (on books and records) and G-9 (on preservation of records) requiring municipal advisors to make and keep books and records related to their supervisory and compliance obligations.

## Summary of Draft Rule G-44 and Draft Amendments to Rules G-8 and G-9

As explained in detail below, draft Rule G-44 follows a widely accepted model in the securities industry of a reasonable supervisory system complemented by the designation of a chief compliance officer (CCO). The draft rule draws on aspects of existing supervision and compliance regulation under other regimes, including those for broker-dealers under rules of the MSRB and the Financial Industry Regulatory Authority (FINRA) and for investment advisors under the Investment Advisers Act of 1940 (Advisers Act).

In summary, draft Rule G-44 requires:

- A supervisory system reasonably designed to achieve compliance with applicable securities laws;
- Written supervisory procedures;
- The designation of one or more municipal advisor principals to be responsible for supervision;
- Compliance processes reasonably designed to achieve compliance with applicable securities laws;
- The designation of a chief compliance officer to administer those compliance processes; and
- At least annual reviews of compliance policies and supervisory procedures.

The draft amendments to Rules G-8 and G-9, in summary, require each municipal advisor to make and keep records of:

- Written supervisory procedures;
- Designations of persons as responsible for supervision;
- Written compliance policies;
- Designations of persons as CCO; and
- Reviews of compliance policies and supervisory procedures.

## Request for Comment

### Draft Rule G-44

Paragraph (a) of draft Rule G-44 contains the core principle that all municipal advisors must have a system to supervise their municipal advisory activities that is reasonably designed to achieve compliance with all applicable securities laws, including MSRB rules. Subparagraph (a)(i) requires the establishment, implementation, maintenance and enforcement of written supervisory procedures reasonably designed to achieve compliance with applicable securities laws. Paragraph .01 of the Supplementary Material specifies several factors that municipal advisors' written supervisory procedures must take into consideration, including the advisor's size, organizational structure, nature and scope of activities, and number of offices. This guidance allows municipal advisors to tailor their supervisory procedures to, among other things, their size, particular business model and structure. Paragraph .02 of the Supplementary Material emphasizes the flexibility of the draft rule to accommodate small municipal advisor firms, even those with only one associated person. Draft Rule G-44(a)(i) also specifies requirements to promptly amend supervisory procedures and communicate them to the municipal advisor's relevant associated persons.

Draft Rule G-44(a)(ii) requires municipal advisors to designate one or more municipal advisor principals<sup>2</sup> to be responsible for the supervision required by the draft rule. Paragraph .03 of the Supplementary Material specifies the authority and specific qualifications required for municipal advisory principals designated as responsible for supervisory functions. They must have the authority to carry out the supervision for which they are responsible, including the authority to implement the municipal advisor's established written supervisory procedures and take any other action necessary to fulfill their responsibilities. They also must have sufficient knowledge, experience and training to understand and effectively discharge their supervisory responsibilities.

Paragraph (b) of draft Rule G-44 requires municipal advisors to implement processes to establish, maintain, review, test and modify written compliance policies and supervisory procedures. Draft Rule G-44(b) specifies that the reviews of the compliance policies and supervisory procedures must be conducted at least annually. Paragraph .04 of the Supplementary Material

---

<sup>2</sup> The MSRB intends to propose amendments to MSRB Rules G-2 and G-3 to create the "municipal advisor principal" classification, define the term and require qualification in accordance with the rules of the MSRB.

provides, however, that municipal advisors should consider the need, in order to comply with all of the other requirements of the draft rule, for more frequent reviews. Paragraph .04 of the Supplementary Material also provides guidance on what, at a minimum, municipal advisors should consider during their reviews of compliance policies and supervisory procedures. These considerations include any compliance matters that arose since the previous review, any changes in municipal advisory activities and any changes in applicable law.

Paragraph (c) of draft Rule G-44 requires municipal advisors to designate one individual as their CCO. Paragraph .05 of the Supplementary Material explains the role of a CCO and the importance of that role. Specifically, a CCO is a primary advisor to the municipal advisor on its overall compliance scheme and the policies and procedures that the municipal advisor adopts in order to comply with applicable law. To fulfill this role, a CCO should have competence in the process of (1) understanding activities that need to be the subject of compliance policies and supervisory procedures; (2) identifying the law applicable to those activities; (3) developing policies and procedures that are reasonably designed to achieve compliance with applicable law; and (4) testing compliance with the municipal advisor's policies and procedures. These qualifications of a CCO draw on those specified in FINRA's CCO requirement for its member firms.<sup>3</sup> Paragraph .05 further explains that the chief compliance officer can be a principal of the firm or a person external to the firm though in either case, the municipal advisor retains ultimate responsibility for its compliance obligations. This approach to the CCO function in the draft rule, which gives municipal advisors the option to outsource the CCO role, follows the precedent for investment advisers under the Advisers Act.<sup>4</sup>

Paragraph .06 of the Supplementary Material specifies that the CCO, and any compliance officers that report to the CCO, shall have responsibility for and perform the compliance functions required by the draft rule. Paragraph .07 of the Supplementary Material provides that a municipal advisor's CCO may hold any other position within the municipal advisor, including senior management positions, so long as the person can discharge the duties of chief compliance officer in light of all of the responsibilities of any other positions. This guidance is especially relevant to small municipal advisors, including sole proprietorships and other one-person entities. It makes clear

---

<sup>3</sup> See FINRA Rule 3130 Supplementary Material .05.

<sup>4</sup> See Section 202(25) of the Advisers Act and Rule 206(4)-7, 17 CFR § 275.206(4)-7.

that a single individual may, for example, serve under appropriate circumstances as CEO, supervisory principal and CCO. In addition, as discussed above, the CCO may be an external consultant.

### **Draft Amendments to Rules G-8 and G-9**

Draft Rule G-44 is accompanied by related draft amendments to Rules G-8 (on books and records) and G-9 (on preservation of records). The draft amendments require each municipal advisor to make and keep records of written supervisory procedures and compliance policies, designations of persons as CCO and persons responsible for supervision, and reviews of the adequacy of written compliance policies and written supervisory procedures. The draft amendments require that records relating to designations of persons responsible for supervision and designations of persons as chief compliance officer be preserved for the period of designation of each person designated and for at least six years following any change in such designation. The six-year preservation requirement is consistent with the current provisions of Rule G-9 for records of similar designations by brokers, dealers and municipal securities dealers. The draft amendments to Rule G-9 require the other records related to municipal advisors' supervisory and compliance obligations to be preserved for five years, which is consistent with the preservation requirements of Rule 15Ba1-8 (Books and records to be made and maintained by municipal advisors)<sup>5</sup> under the Securities Exchange Act of 1934 (Exchange Act).<sup>6</sup>

### **Economic Analysis**

The MSRB is sensitive to the costs imposed by its rules and has sought to tailor the draft rule and draft amendments so as not to impose unnecessary or inappropriate costs and burdens on municipal advisors. In accordance with this policy, the Board considered the following factors with respect to draft Rule G-44 and the draft amendments to Rules G-8 and G-9: 1) the need for the draft rule and how it will meet that need; 2) relevant baselines against which the likely economic impact of elements of the draft rule can be measured; 3) reasonable alternative regulatory approaches; and 4) the potential benefits and costs of the draft rule and the main alternative regulatory approaches. Each of these factors is discussed in detail below.

---

<sup>5</sup> 17 CFR § 240.15Ba1-8.

<sup>6</sup> Draft Rule G-8(h) includes reserved subparagraphs (i) and (ii), for books and records provisions that the MSRB has proposed in connection with draft Rule G-42, on duties of non-solicitor municipal advisors. See MSRB Notice 2014-01 (Jan. 9, 2014). The MSRB will make conforming changes to this proposal as appropriate depending on future actions by the MSRB and SEC related to draft Rule G-42.

## **1. The need for the draft rule and how it will meet that need.**

The need for draft Rule G-44 arises from the MSRB's regulatory oversight of municipal advisors as provided under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).<sup>7</sup> The Dodd-Frank Act establishes a federal regulatory regime that requires municipal advisors to register with the Securities and Exchange Commission (SEC) and grants the MSRB certain regulatory authority over municipal advisors. The MSRB, in the exercise of that authority, is in the process of developing a regulatory framework for municipal advisors. Supervision and compliance functions play an important role in promoting and fostering compliance with all applicable securities laws by municipal advisors, including MSRB rules. Such functions are complementary to an enforcement program designed to deter violations of securities laws by imposing penalties after violations occur. Supervision and compliance functions, by contrast, are designed to prevent violations from occurring, while they also promote early detection and prompt remediation of violations when they do occur.

For similar reasons, the regulation of supervisory and compliance functions is well established within the financial services industry. The model of requiring written supervisory procedures complemented by the designation of a CCO to be responsible for compliance processes is a widely accepted regulatory model across the financial services industry. To achieve comparable levels of compliance with applicable securities laws as seen with other financial services professionals, there is a need for an MSRB rule governing municipal advisors' supervisory and compliance obligations.

## **2. Relevant baselines against which the likely economic impact of elements of the draft rule can be measured.**

To evaluate the potential impact of the draft rule's requirements, a baseline, or baselines, must be established as a point of reference. The analysis proceeds by comparing the expected state with draft Rule G-44 in effect to the baseline state prior to the rule taking effect. The economic impact of the draft rule is measured as the difference between these two states.

One baseline that can be used to evaluate the impact of draft Rule G-44 is the Dodd-Frank Act itself which subjects municipal advisors to regulation by the MSRB. The Dodd-Frank Act mandates that MSRB rulemaking, at a minimum, prescribe means reasonably designed to prevent municipal

---

<sup>7</sup> Pub. Law No. 111-203, 124 Stat. 1376 (2010).

advisors from breaching their fiduciary duty to their clients. Draft Rule G-44, if adopted, would be put into effect after the adoption of draft Rule G-42, on the duties of non-solicitor municipal advisors, which provides guidance on avoiding breaches of a municipal advisor's fiduciary duty. A supervisory program and compliance program as required in draft Rule G-44 follows as a natural consequence of draft Rule G-42 as it prescribes a widely recognized means of preventing misconduct. As a more general matter, the legislative history of the Dodd-Frank Act indicates Congress was concerned with the previously unregulated activities of municipal advisors. It is reasonable to conclude that Congress, in subjecting municipal advisors to regulation in the Dodd-Frank Act, contemplated a regulatory regime comparable to the regulatory regimes for other entities and persons in the financial services industry, at least to the fundamental extent of requiring reasonable supervisory and compliance functions to be performed.

For the subset of municipal advisors that are municipal securities dealers, the existing supervisory requirements of MSRB Rule G-27 serve as a baseline. For this subset of municipal advisors, the draft Rule G-44 supervisory requirements are no more stringent than the baseline Rule G-27 requirements.

For the subset of municipal advisors that are also FINRA-registered dealers of municipal securities, the FINRA supervision and compliance requirements also serve as a baseline. The relevant FINRA rules require, among other things, that each dealer have a reasonable supervisory system, comprehensive compliance processes, and a CCO.

An additional baseline applies to municipal advisors who are also registered as investment advisers and subject to the requirements of the Advisers Act. The Advisers Act gives the SEC authority to punish failures by investment advisers (IAs) to reasonably supervise. In addition, the SEC requires IAs to have written compliance policies and procedures and designate a CCO as responsible for the administration of those procedures.

### **3. Identifying and evaluating reasonable alternative regulatory approaches.**

One alternative to adopting draft Rule G-44 would be for the MSRB not to engage in additional rulemaking and, thus, not establish minimum supervisory and compliance requirements for municipal advisors. In the absence of a minimum regulatory regime, municipal advisors would be relied on to determine the minimum elements of their supervisory and compliance programs, if any. To the extent that some municipal advisors might

implement programs that fail to meet the minimum elements specified in draft Rule G-44, or do not engage in this type of oversight, some benefits of the draft rule could be lost. Municipal advisors may have less robust procedures to prevent violations of applicable rules from occurring, a reduced ability to detect violations when they do occur, and a reduced ability to promptly remediate violations before the occurrence of more serious consequences.

Another alternative is for the MSRB to use a solely principles-based approach to its rulemaking on this subject. Under this approach, the regulatory objectives would be specified but individual firms would be free to select the means used to meet the objectives. Such an approach, however, would involve tradeoffs in terms of costs and benefits. A more principles-based approach would afford municipal advisors flexibility in determining the lowest-cost means to meet the regulatory objectives. But a more principles-based approach might require additional communication on the interpretation of regulatory objectives which could require additional MSRB rulemaking or interpretive action.

Another alternative would be to consider whether the supervisory requirements for municipal advisors should be included as part of the supervisory requirements for municipal securities broker-dealers under MSRB Rule G-27 instead of being organized in a separate rule. The significant differences in the activities of municipal advisors and the typical core activities of broker-dealers, however, support having a separate rule.

The MSRB invites public comment to suggest other potential regulatory alternatives.

#### **4. Assessing the benefits and costs, both quantitative and qualitative, of the draft rule and the main alternative regulatory approaches.**

The MSRB policy on economic analysis in rulemaking addresses consideration of the likely economic consequences of the draft rule, against the context of the economic baselines discussed above.

At the outset, the MSRB notes it is currently unable to quantify the economic effects of draft Rule G-44 and the amendments to Rules G-8 and G-9 because the information necessary to provide reasonable estimates is not available. The MSRB observes, as the SEC also observed in its Final Rule, that there is little publicly available information about the municipal advisory industry. In addition, estimating the costs for municipal advisory firms to comply with the draft rule is hampered by the fact that these costs depend on the business



activities and size of these municipal advisory firms, which can vary greatly. Given the limitations on the MSRB's ability to conduct a quantitative assessment of the costs and benefits associated with the draft rule, the MSRB has thus far considered these costs and benefits primarily in qualitative terms.

**Benefits**

A principal benefit of draft Rule G-44 is that it is expected to help promote compliance by municipal advisors with all applicable securities laws including, but not limited to, anti-fraud provisions of the Exchange Act, the conduct standards of Rule G-17, the statutory fiduciary duty for municipal advisors in dealing with municipal entity clients, and the standards of conduct and duties for municipal advisors under draft Rule G-42. Draft Rule G-44 is intended to prevent unlawful conduct and to help detect and promptly address unlawful conduct when it does occur.

The benefits of draft Rule G-44 are complementary to existing securities laws and MSRB rules in that the benefits of these standards as applicable to municipal advisors likely would not be fully realized without the supervisory and compliance requirements of draft Rule G-44. To this extent, draft Rule G-44 has potential benefits similar to those of these applicable securities laws, including the protection of investors, municipal entities, and obligated persons and the promotion of a fair and efficient municipal securities market.

**Costs**

The MSRB's analysis of the potential costs does not consider all of the costs associated with the draft rule, but instead focuses on the incremental costs attributable to its implementation that exceed costs associated with the baseline state. The costs associated with the baseline state are, in effect, subtracted from the costs associated with the draft rule to isolate the costs attributable to the incremental requirements of the draft rule.

The costs associated with the requirements of draft Rule G-44 would be most pronounced as the supervisory and compliance programs are implemented for the first time. These costs would be associated with such steps as identifying applicable laws, drafting supervisory procedures, drafting compliance policies, and developing programs to test compliance. These start-up costs may be significant for some market participants depending on the size and nature of their business. These costs may include seeking the advice of compliance and legal professionals. In addition, once the programs are implemented, municipal advisors would incur recurring costs of maintaining ongoing programs.

The costs associated with the draft rule may fall disproportionately on small municipal advisory firms, including sole proprietorships. To address this concern, the draft rule allows for small advisors, and advisors with other particular traits, to reasonably vary their supervisory procedures as appropriate. The draft rule also provides that the CCO may hold other positions in the firm and that the CCO function can be outsourced.

Any increase in municipal advisory fees charged to their clients attributable to the incremental costs of the draft rule compared with the baseline state may be, in the aggregate, minimal in that the cost per municipal advisory firm likely would be spread across the number of advisory engagements for each firm. It is possible, however, that for smaller municipal advisors with fewer clients, the incremental costs associated with the requirements of the draft rule may represent a greater percentage of annual revenues, and, thus, such advisors may be more likely to pass those costs along to their advisory clients.

The Dodd-Frank Act provides that MSRB rules may 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. The MSRB is sensitive to the potential impact of the requirements contained in draft Rule G-44 on small municipal advisors. The MSRB understands that some small municipal advisors and solo practitioners, unlike larger municipal advisory firms, may not employ full-time compliance staff and that the cost of ensuring compliance with the requirements of the draft rule may be proportionally higher for these smaller firms. The MSRB, preliminarily, believes that the draft rule is consistent with the Dodd-Frank Act's provision with respect to burdens imposed on small municipal advisors. In order to minimize any significant burdens on small municipal advisors, however, the MSRB is particularly interested in receiving meaningful feedback regarding the potential economic impact of the draft rule and draft amendments on small municipal advisors. The MSRB will consider such feedback in light of the Dodd-Frank Act provision.

### **Effect on Competition, Efficiency and Capital Formation**

Finally, it is possible that, as a result of the costs associated with the supervision and compliance requirements of the draft rule relative to the baseline, some municipal advisors may decide to exit the market, curtail their activities, or consolidate with other firms. For example, some municipal advisors may determine to consolidate with other municipal advisors in order to benefit from economies of scale (*e.g.*, by leveraging existing compliance resources of a larger firm) rather than to incur separately the costs

associated with the draft rule. It is also possible that some of the municipal advisors that may exit the market could be small municipal advisors doing so for financial reasons. Such exits from the market may lead to a reduced pool of municipal advisors. However, as the SEC recognized in its final rule on the permanent registration of municipal advisors, the market for municipal advisory services is likely to remain competitive despite the potential exit of some municipal advisors (including small entity municipal advisors), consolidation of municipal advisors, or lack of new entrants into the market.<sup>8</sup>

### **General Matters**

In addition to any other subject which commenters may wish to address related to draft Rule G-44 and the draft amendments to Rules G-8 and G-9, the MSRB seeks public comment on the specific questions below. In particular, the MSRB requests public comment on the potential economic consequences which may result from the adoption of draft Rule G-44 and the draft amendments to Rules G-8 and G-9. The MSRB welcomes information regarding the potential to quantify likely benefits and costs. In addition, the MSRB requests comment to help identify the potential benefits and costs of the regulatory alternatives suggested by commenters. The MSRB also requests comment on any competitive or anticompetitive effects, as well as efficiency and capital formation effects, of the draft rule and draft amendments on any market participants. Commenters are encouraged to provide statistical, empirical, and other data from commenters that may support their views and/or support or refute the views or assumptions contained in this request for comment.

The MSRB specifically requests that commenters address the following questions:

- 1) Does draft Rule G-44 strike an appropriate balance between a principles-based and a prescriptive approach to supervision? If not, explain why and in what areas draft Rule G-44 should be more principles-based or prescriptive.
- 2) Is draft Rule G-44 appropriately accommodating for small and single person municipal advisors? If not, describe how the draft rule can be modified to be more appropriately accommodating.
- 3) Do commenters agree or disagree that municipal advisors should be able to outsource the CCO function pursuant to the draft rule and

---

<sup>8</sup> Exchange Act Release No. 70462, at p. 506 (Sept. 20, 2013), 78 FR 67467, at p. 67608 (Nov. 12, 2013).

that the CCO should not be required to be a principal or even an associated person of the municipal advisor?

- 4) Should draft Rule G-44 require municipal advisors to complete a periodic self-certification regarding the meeting of professional qualification standards by its associated persons and the municipal advisor's ability to comply, and history of complying, with all applicable regulatory requirements?
- 5) Do commenters agree or disagree that a need exists for the MSRB to articulate the supervision and compliance obligations of municipal advisors? Do commenters agree or disagree that the draft rule addresses that need?
- 6) Are the various baselines proposed to be used appropriate baselines? Are there other relevant baselines that the MSRB should consider?
- 7) To the extent that draft Rule G-44 and the draft amendments to Rules G-8 and G-9 impose costs on municipal advisors, will these costs be passed on to municipal entities or obligated persons in the form of higher fees?
- 8) What are the initial and ongoing costs associated with making and preserving the additional records required by the draft amendments to Rules G-8 and G-9?
- 9) Will draft Rule G-44 have benefits in terms of protecting municipal entities, obligated persons and investors?
- 10) Are there additional potential costs or benefits that the MSRB should consider? If so, please explain.
- 11) What alternatives to the form of draft Rule G-44 should the MSRB consider? How would the costs and benefits of such alternatives differ from those associated with the draft rule?
- 12) If draft Rule G-44 were adopted, what would be the likely effects on competition, efficiency and capital formation?
- 13) Would the requirements of draft Rule G-44 impose any burden on small municipal advisors that is not necessary or appropriate?

February 25, 2014

## Text of Draft Rule and Amendments<sup>9</sup>

### **Rule G-44: Supervisory and Compliance Obligations of Municipal Advisors**

(a) *Supervisory System.* Each municipal advisor shall establish, implement, and maintain a system to supervise the municipal advisory activities of the municipal advisor and its associated persons that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable Board rules (“applicable rules”). Final responsibility for proper supervision shall rest with the municipal advisor. A municipal advisor’s supervisory system shall provide, at a minimum, for the following:

(i) *Written Supervisory Procedures.* The establishment, implementation, maintenance and enforcement of written supervisory procedures that are reasonably designed to ensure that the conduct of the municipal advisory activities of the municipal advisor and its associated persons are in compliance with applicable rules. The written supervisory procedures shall be promptly amended to reflect changes in applicable rules and as changes occur in the municipal advisor’s supervisory system, and such procedures and amendments shall be promptly communicated to all associated persons to whom they are relevant based on their activities and responsibilities.

(ii) *Appropriate Principal.* The designation of one or more municipal advisory principals to be responsible for the supervision required by this rule.

(b) *Compliance Processes.* Each municipal advisor shall have in place and implement processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable rules, and shall conduct, no less frequently than annually, a review of the compliance policies and supervisory procedures.

(c) *Chief Compliance Officer.* Each municipal advisor shall designate one individual to serve as its chief compliance officer.

(d) *Definitions.*

(i) “Municipal advisor,” for purposes of this rule, shall mean a municipal advisor registered or required to be registered under section 15B of the Act and rules and regulations thereunder.

#### **---Supplementary Material:**

**.01 Written Supervisory Procedures.** A municipal advisor’s written supervisory procedures shall take into consideration, among other things, the advisor’s size; organizational structure; nature and scope of municipal advisory activities; number of offices; the disciplinary and legal history of its associated persons; the likelihood that associated persons may be engaged in relevant outside business activities; and any indicators of irregularities or misconduct (*i.e.*, “red flags”).

<sup>9</sup> Underlining indicates new language; strikethrough denotes deletions.

**.02 Small Municipal Advisors.** A municipal advisor with few personnel, or even only one associated person, can have a sufficient supervisory system under this rule. The rule allows the designation of one person to be responsible for supervision, and allows the tailoring of written supervisory procedures based on, among other things, an advisor's size. In the case of a municipal advisor with a single associated person, the written supervisory procedures must address the manner in which, in the absence of separate supervisory personnel, such procedures are nevertheless reasonably designed to achieve compliance with applicable rules.

**.03 Appropriate Principal.** Designated supervisory principals must be vested with the authority to carry out the supervision for which they are responsible and have sufficient knowledge, experience and training to understand and effectively discharge their responsibilities. They also must have the authority to implement the established written supervisory procedures and take any other action necessary to fulfill their responsibilities. Even if not so designated, whether a person has responsibility for supervision under this rule depends on whether, under the facts and circumstances of a particular case, that person has the requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue.

**.04 Review of Compliance Policies and Supervisory Procedures.** The reviews under paragraph (b) of this rule should, at a minimum, consider any compliance matters that arose since the previous review, any changes in the municipal advisory activities of the municipal advisor or its affiliates, and any changes in applicable rules that might suggest a need to revise the written compliance policies or supervisory procedures. Although paragraph (b) specifically requires reviews to be conducted at least annually, municipal advisors should consider the need, in order to comply with all of the other requirements of this rule, for interim reviews.

**.05 Chief Compliance Officer.** A chief compliance officer has a unique and integral role in the administration of a municipal advisor's compliance processes. A chief compliance officer is a primary advisor to the municipal advisor on its overall compliance scheme and the policies and procedures that the municipal advisor adopts in order to comply with applicable rules. To fulfill this role, a chief compliance officer should have competence in the process of (1) gaining an understanding of the services and activities that need to be the subject of written compliance policies and written supervisory procedures; (2) identifying the applicable rules and standards of conduct pertaining to such services and activities based on experience and/or consultation with others; (3) developing, or advising other business persons charged with the obligation to develop, policies and procedures that are reasonably designed to achieve compliance with applicable rules and standards of conduct; and (4) developing programs to test compliance with the municipal advisor's policies and procedures. It is the intention of this rule to foster regular and significant interaction between senior management and the chief compliance officer regarding the municipal advisor's comprehensive compliance program. The chief compliance officer may be a principal of the firm or a non-employee of the firm. If a non-employee, then the person designated as chief compliance officer must have the competence described above and the municipal advisor retains ultimate responsibility for its compliance obligations.

**.06 Responsibility for Compliance Functions.** The chief compliance officer, and any compliance officers that report to the chief compliance officer, shall have responsibility for and perform the compliance functions contemplated by this rule. Nothing in this rule, however, is intended to limit or discourage the participation by any of the employees of the municipal advisor in any aspect of the municipal advisor's compliance program.

**.07 Ability of Chief Compliance Officer to Hold Other Positions.** The requirement to designate a chief compliance officer does not preclude that person from holding any other positions within the municipal advisor, including serving in any position in senior management or being designated as a supervisory principal, provided that person can discharge the duties of chief compliance officer in light of all of the responsibilities of any other positions.

\* \* \* \* \*

**Rule G-8: Books and Records to be Made by Brokers, Dealers, and Municipal Securities Dealers, and Municipal Advisors**

(a) - (g) No change.

**(h) Municipal Advisor Records.** Every municipal advisor that is registered or required to be registered under section 15B of the Act and the rules and regulations thereunder shall make and keep current the following books and records:

(i) Reserved.<sup>10</sup>

(ii) Reserved.

**(iii) Records Concerning Compliance with Rule G-44.**

**(A) The written supervisory procedures required by Rule G-44(a)(i);**

**(B) A record of all designations of persons responsible for supervision as required by Rule G-44(a)(ii).**

**(C) Records of the reviews of written compliance policies and written supervisory procedures as required by Rule G-44(a) and (b); and**

**(D) A record of all designations of persons as chief compliance officer as required by Rule G-44(c).**

<sup>10</sup> As previously noted, draft Rule G-8(h) includes reserved subparagraphs (i) and (ii), for books and records provisions that the MSRB has proposed in connection with draft Rule G-42. See *supra* n.6.

\* \* \* \* \*

**Rule G-9: Preservation of Records**

(a) - (g) No change.

(h) *Municipal Advisor Records*. Every municipal advisor shall preserve the books and records described in Rule G-8(h) for a period of not less than five years, provided that the records described in Rule G-8(h)(iii)(B) and (D) shall be preserved for the period of designation of each person designated and for at least six years following any change in such designation.