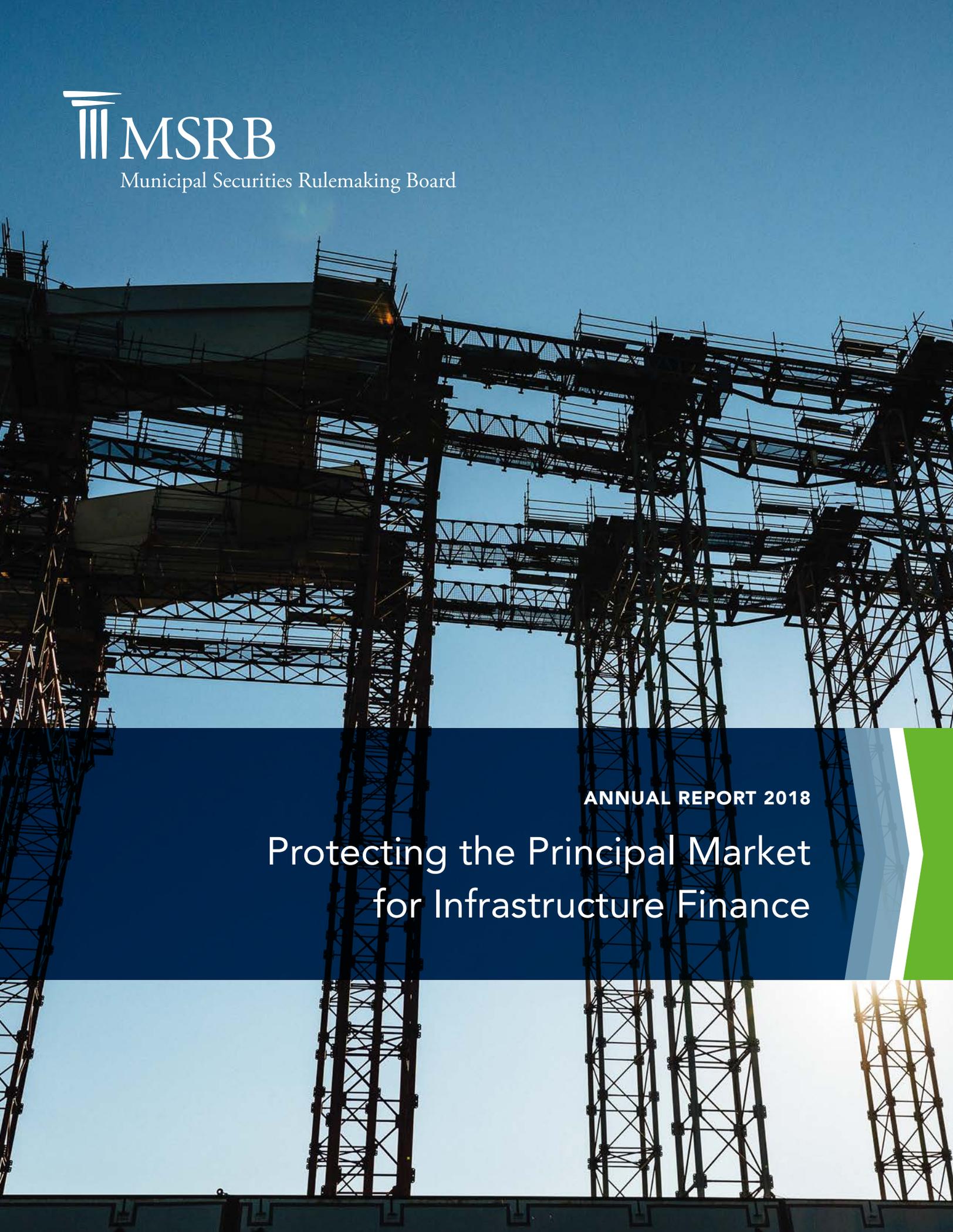




Municipal Securities Rulemaking Board

ANNUAL REPORT 2018

# Protecting the Principal Market for Infrastructure Finance



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## ABOUT THE MSRB

The Municipal Securities Rulemaking Board (MSRB) protects investors, state and local governments and other municipal entities, and the public interest by promoting a fair and efficient municipal securities market. The MSRB fulfills this mission by regulating the municipal securities firms, banks and municipal advisors that engage in municipal securities and advisory activities. To further protect market participants, the MSRB provides market transparency through its Electronic Municipal Market Access (EMMA<sup>®</sup>) website, the official repository for information on virtually all municipal bonds. The MSRB also serves as an objective resource on the municipal market, conducts extensive education and outreach to market stakeholders, and provides market leadership on key issues. The MSRB is a Congressionally chartered, self-regulatory organization governed by a 21-member board of directors that has a majority of public members, in addition to representatives of regulated entities. The MSRB is subject to oversight by the Securities and Exchange Commission.



Gary Hall

## MESSAGE FROM THE CHAIR

As the self-regulatory organization (SRO) dedicated to overseeing the \$3.9 trillion municipal securities market, the Municipal Securities Rulemaking Board (MSRB) regularly engages in strategic planning to evaluate, and adjust if necessary, how the MSRB ensures a fair and efficient municipal securities market. Eighteen months ago, after soliciting input from key stakeholders and market participants, the MSRB Board of Directors established new, multi-year strategic goals that, in addition to continuing to focus on necessary market oversight and the Electronic Municipal Market Access (EMMA®) website, emphasize compliance support, market data, financial stewardship and the MSRB's role as an SRO.

The fiscal year that ended on September 30, 2018 was the first year in which the MSRB operationalized these new goals. It was also the year in which the MSRB's landmark investor protection rule that allows individual investors to better understand the cost of municipal securities transactions was implemented. And 2018 also marked the 10th anniversary of our EMMA website, which we commemorated with a significant overhaul and additional features.

I believe these initiatives in 2018 demonstrate the MSRB's ability to adjust to a new era of market oversight, while maintaining its commitment to protecting investors and municipal entities, and ensuring that EMMA remains the crown jewel of municipal market transparency.

The expertise of the Board, coupled with perspective and insight we glean from other municipal market stakeholders, enables the MSRB to be responsive to change so that our regulatory and transparency initiatives keep pace with the evolution of the market. The strategic pivot to providing additional compliance support for regulated entities stemmed from significant regulatory changes since 2012 that were largely a result of expanded Congressional oversight of the financial markets and a focus by the U.S. Securities and Exchange Commission (SEC) specifically on the municipal securities market. (see p. 4).

One key rule implemented in 2018 is the requirement for dealers to provide individual investors with information about dealer compensation for municipal securities transactions. The MSRB rule, which helps investors better understand the cost of buying or selling a bond, is consistent with our role to enhance transparency in the market and support efforts to provide regulatory consistency across markets, where possible.

Last year, the MSRB also turned its focus to optimizing the use and dissemination of municipal market data to further support market transparency. Efforts to evaluate our market data in 2018 positioned us for a deeper analysis in 2019 on how to best ensure long-term reliability of our market transparency systems, data quality and security.

The MSRB promotes transparency not just for the municipal market, but in its governance and financial practices. In October 2017, the MSRB published its first-ever budget summary to better convey its commitment to assessing fair and equitable fees, diversifying funding sources and spending responsibly.

The SRO model is unique and relies on the feedback of the public and market participants to ensure market efficiency and practical, effective regulation. The SRO model also benefits from specialized expertise that can generate important insights and perspectives. To ensure that these "assets" are shared broadly with the market, the MSRB published several new reports in 2018 that add to the market's understanding of important trends and developments. (see p. 8).

2018 was a year of change and progress for the MSRB. Effective oversight of the municipal securities market depends on collaboration with market participants and other securities regulators. We are committed to this stakeholder engagement, and as we continue to expand on our strategic initiatives, I encourage your participation and welcome your input.

Sincerely,

Gary Hall, Chair, Board of Directors

# Market Oversight

Ushering in a historic change for the municipal securities market, in 2018, the MSRB implemented investor protection regulations that require dealers to disclose to individual investors information about dealer compensation for certain transactions. As a result of the rule that went into effect in May 2018, individual investors now know how much it costs to execute a municipal securities transaction, helping them to better understand the total cost of buying or selling a municipal bond and providing increased transparency on municipal securities transactions.

Working in coordination with the Financial Industry Regulatory Authority (FINRA), which implemented a similar rule for the corporate and agency debt markets, the MSRB established its mark-up disclosure regime to be consistent with other fixed-income markets to allow a more uniform compliance approach and provide clarity for investors. The MSRB rule requires a dealer to disclose, on the customer's confirmation, the dealer's compensation in the form of a "mark-up" or "mark-down" from the "prevailing market price" of the

security. In addition to including the dollar amount and percentage of the dealer's compensation on a trade, the confirmation includes the time of the investor's trade and a link to trade price data about the security on the EMMA website.

To help investors and financial professionals understand the new rule, the MSRB produced educational materials and provided dealers with guidance on establishing the prevailing market price of a security. The guidance builds on existing guidance under the MSRB's fair pricing rules, which requires dealers to use reasonable diligence in establishing the prevailing market price of a municipal security and is generally harmonized with prevailing market price guidance previously adopted by FINRA and applicable to other fixed income securities.

In preparing for implementation of the rule, the MSRB acknowledged challenges for dealers addressing such a major regulatory change and took steps to support market understanding of the rule's provisions and the technical aspects of implementation. Following initial implementation of guidance

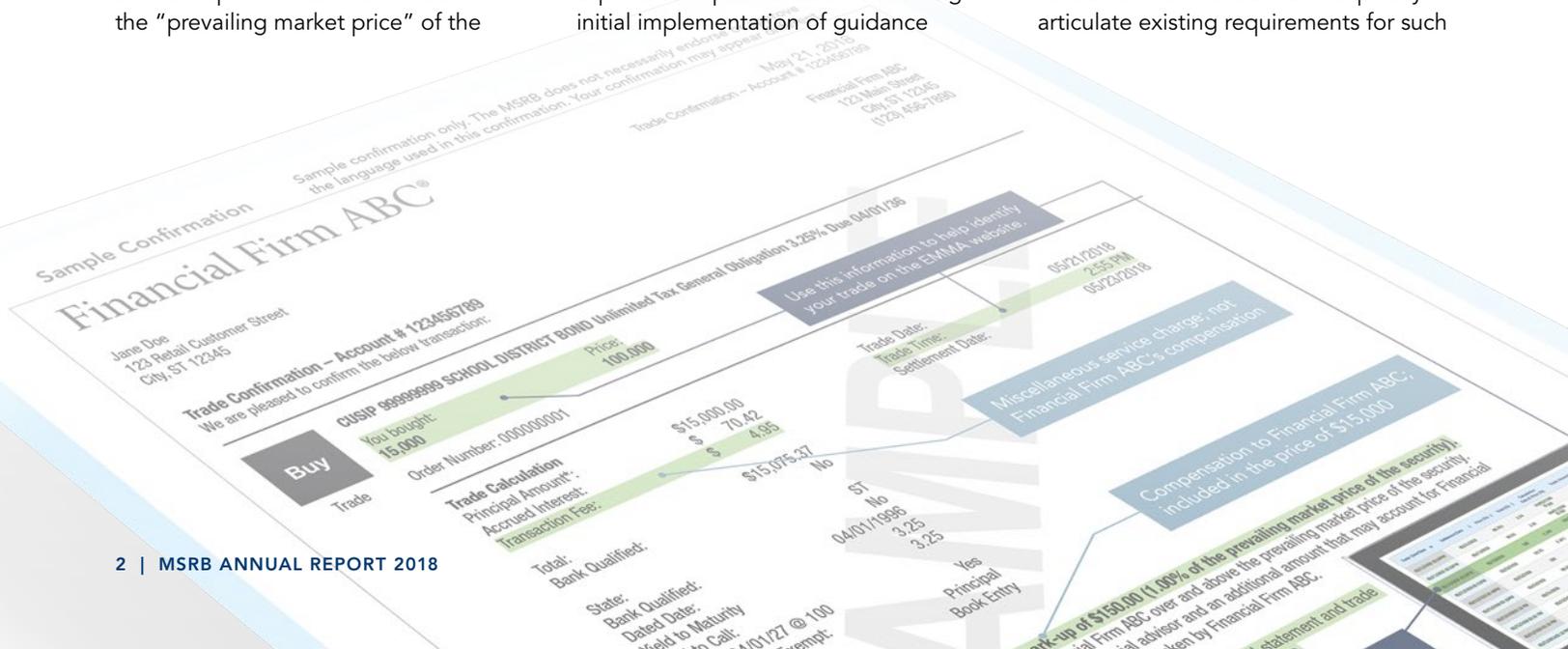
produced in 2017, the MSRB made available an online course for dealers on applying the mark-up rule to real-world scenarios. The course is part of the MSRB's MuniEdPro® catalog and was available for free through the rule's implementation date in May 2018.

## Retrospective Rule Review

The MSRB recognizes that to be effective and promote market efficiencies, rules must be responsive to changes in the market and, where appropriate, be consistent with rules of other financial market regulators. To address these imperatives, the MSRB regularly considers and evaluates its rules, and proposes additions, deletions or other revisions as appropriate. In 2018, the MSRB's retrospective rule review included rules for dealers on primary offering practices, discretionary accounts, advertising and required disclosures to municipal entities.

In 2018, the MSRB also published draft amendments to MSRB [Rule G-11](#) and MSRB [Rule G-32](#) regarding syndicate practices and disclosure requirements around primary offerings, and continues to evaluate the need for any necessary updates.

In another retrospective rule review, the MSRB evaluated requirements related to discretionary transactions in customer accounts to consolidate and explicitly articulate existing requirements for such



transactions, among other changes. Any future amendments will seek to provide clarity to dealers, securities firms and banks on their obligations related to discretionary transactions in customer accounts and improve consistency with similar rules of other securities regulators.

As part of the ongoing review of its rules and published interpretations, in 2018, the MSRB requested comment on interpretive guidance it issued in 2012 on the application of MSRB [Rule G-17](#), on conduct of municipal securities and municipal advisory activities, to underwriters of municipal securities. The guidance established duties underwriters owe to issuers pursuant to their fair-dealing obligation. The MSRB received comments from market participants concerning the effectiveness and practical application of the 2012 guidance, and in November 2018, proposed amendments to streamline the guidance in a way that does not compromise its regulatory intent regarding the protection of issuers.

In September 2018, the MSRB [published for comment proposed draft interpretive guidance related to the practice of “pennying,”](#) which can occur when a dealer purchases bonds for its own account following the solicitation and review of bids on

a municipal security for a customer who is seeking to sell the security. When viewed in isolation, this practice may appear to benefit the customer, as the dealer technically provides the customer a price that is equal to, or nominally better than, the best bid obtained through the bid solicitation process. However, widespread pennyning may have harmful effects for investors, bidding dealers and the market as a whole. The MSRB also published for comment draft amendments to existing guidance on best execution of municipal securities relating to the bid the solicitation process.

### Municipal Advisor Regulations

In 2018, the MSRB completed development of the foundational regulatory framework for municipal advisors. [MSRB Rule G-40](#), a new advertising rule for municipal advisors, will go into effect in 2019. MSRB [Rule G-40](#) outlines policies around advertising to municipal entities or the public at large. In conjunction with the new rule, the MSRB is developing three resources to support successful implementation of MSRB Rule G-40. These resources address advertising content standards, the use of social media and municipal advisor client lists and case studies.

The MSRB also develops competency standards for municipal finance professionals. Last year, the MSRB made changes to its professional qualification requirements, leading to amendments to MSRB [Rule G-3](#) and the development of a new professional qualification examination—the Series 54—for municipal advisors acting in a principal, that is, managerial or supervisory capacity. To be qualified as a municipal securities principal, municipal advisors are now required to take and pass both the existing [Series 50](#) and new Series 54. A pilot version of the new Series 54 exam will be made available in early 2019, and any municipal securities advisor acting in a principal capacity can take the pilot exam during this period. When the permanent version of the Series 54 examination becomes available thereafter, all municipal advisors acting in a principal capacity will have one year to take and pass the exam to remain compliant with MSRB requirements.

In October 2018, FINRA introduced a new exam for securities industry professionals, the Securities Industry Essentials (SIE). The MSRB participated in the development of the SIE and is accepting it as a pre-requisite to MSRB representative-level exams and amended its Municipal Securities Representative Exam (Series 52) accordingly.



“ The municipal bond market touches every American—either directly or indirectly—everyday. It is the financial driver that ensures our nation’s infrastructure and other key municipal priorities are appropriately funded and well-maintained. Given the nuances of the municipal securities market, it is essential to have an effective regulatory model to ensure an efficient and fair marketplace for all stakeholders—and that is what the MSRB strives to uphold.”

~ Beth Wolchock, MSRB Board Member  
Managing Director and Municipal Principal, Oppenheimer & Co. Inc.

# Expanding Compliance Support

The MSRB expanded its compliance support in 2018 to ensure regulated entities appropriately comply with foundational rules for municipal advisors and new investor protection rules for dealers established over the last several years.

Providing guidance and education for regulated entities has long been a cornerstone of the MSRB’s approach to regulating the municipal securities market. Last year brought a renewed focus for the MSRB for developing guidance and resources that assist and support regulated entities’ ability to develop effective compliance systems and comply with MSRB rules. Facilitating compliance helps ensure MSRB rules achieve their intended purpose of protecting municipal securities investors and issuers. The MSRB expanded its compliance support in 2018 to ensure regulated entities appropriately comply with foundational rules for municipal advisors and new investor protection rules for dealers established over the last several years.

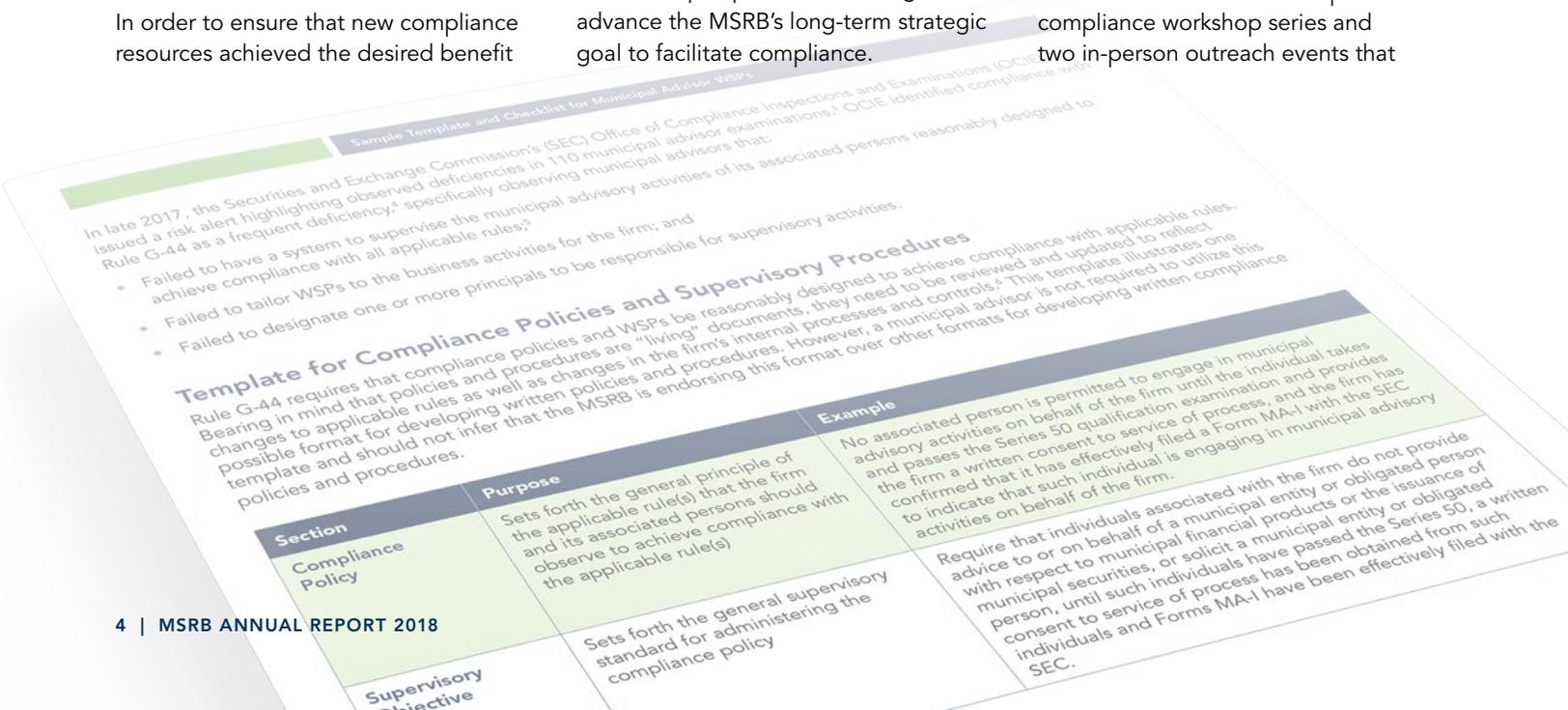
In order to ensure that new compliance resources achieved the desired benefit

of promoting cost-effective compliance, the MSRB took steps to better understand what types of guidance and resources would be most helpful, and to deliver them in convenient ways and formats. The MSRB also recognized the need to clearly communicate the intent and purpose of new compliance resources to distinguish them from formal regulatory guidance.

To leverage the experience and perspectives of regulated entities in shaping its approach to compliance support, the MSRB formed a [Compliance Advisory Group](#), consisting of nine compliance-oriented senior executives representing the diversity of MSRB-regulated firms. These experienced professionals contributed their time, perspectives and insights to advance the MSRB’s long-term strategic goal to facilitate compliance.

Together with feedback received from a [public request for comment](#) and ongoing stakeholder engagement, the Compliance Advisory Group advised the MSRB on the development of 32 new compliance resources on topics ranging from mark-up disclosure for municipal securities dealers to outsourcing compliance functions for municipal advisors. Again, with feedback from the advisory group, the format of the resources varied to include frequently asked questions, checklists and sample templates, along with descriptive educational documents.

In addition to developing new compliance resources, the MSRB conducted outreach to regulated entities to facilitate in-depth discussions about key provisions of MSRB rules. This outreach included a six-part virtual compliance workshop series and two in-person outreach events that



addressed topics such as developing effective supervisory systems at small municipal advisor firms, understanding underwriters' obligations to make disclosures to issuers of municipal securities and implementing the new MSRB rule on mark-up disclosure.

Resources that were developed with the input of stakeholders served as the foundation of the MSRB compliance support in 2018. Stakeholder feedback also helped the MSRB improve the ways in which it communicates about and delivers compliance resources. A new, quarterly *Compliance Corner* newsletter was created to provide a consolidated source of information about compliance topics and resources. A *Compliance Tip of the Week* now delivers a weekly alert of important regulatory topics. A new consolidated online [Compliance Center](#) serves as a repository for all compliance resources and an online compliance calendar provides a forward-look at upcoming compliance deadlines.

The MSRB will continue its focus on compliance support in 2019 with the assistance of a new Compliance Advisory Group and other ongoing stakeholder engagement.

In 2018, to support the MSRB's renewed focus on regulatory compliance, the organization transformed the way in which it communicates compliance-related information to regulated entities, delivering it in ways and at times that are responsive to industry feedback. Four new resources now serve the compliance needs of regulated entities.



### COMPLIANCE CENTER

The Compliance Center on MSRB.org is a consolidated portal where municipal securities dealers and municipal advisors can access compliance resources.



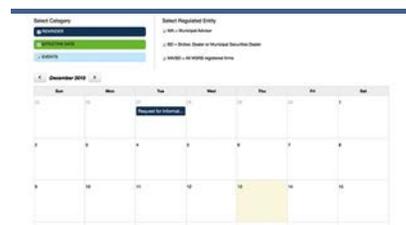
### WEEKLY COMPLIANCE TIP

Every Monday, the Compliance Tip of the Week, delivered via email, provides a brief reminder about an upcoming regulatory deadline or other obligations for regulated entities.



### COMPLIANCE CORNER

The quarterly Compliance Corner newsletter, delivered via email, provides recent compliance-related news and other helpful information.



### COMPLIANCE CALENDAR

The Compliance Calendar on MSRB.org allows regulated entities to look weeks and months ahead for information that can help them prepare for upcoming obligations.



“ We created a Compliance Advisory Group to assist the MSRB in achieving its strategic goal of helping market participants understand and comply with MSRB rules. The group, which is composed of compliance professionals representing broker-dealers, municipal advisors and dually-registered entities as well as other stakeholders in the municipal securities market, will continue to advise the MSRB Board to inform and enhance many of the MSRB compliance resources.”

~ Donna Simonetti, MSRB Board Member

# Building on EMMA's Foundation



Read more about the evolution of the EMMA website in a white paper, [\*Milestones in Municipal Market Transparency\*](#), available on the MSRB's website at [MSRB.org](http://MSRB.org).

For much of the centuries-long history of the municipal securities market, the public lacked access to a free, centralized source of information on the features, risks and pricing of municipal bonds. The launch of the MSRB's EMMA website in March 2008 ensured that individual investors, bond issuers, financial professionals and the public had equal access to bond disclosure and price information, in one place and at no cost. Throughout 2018, the MSRB commemorated 10 years of providing market transparency through EMMA. The commemorations included the unveiling of a series of enhancements to EMMA focused on the usability and utility of the website for individual investors.

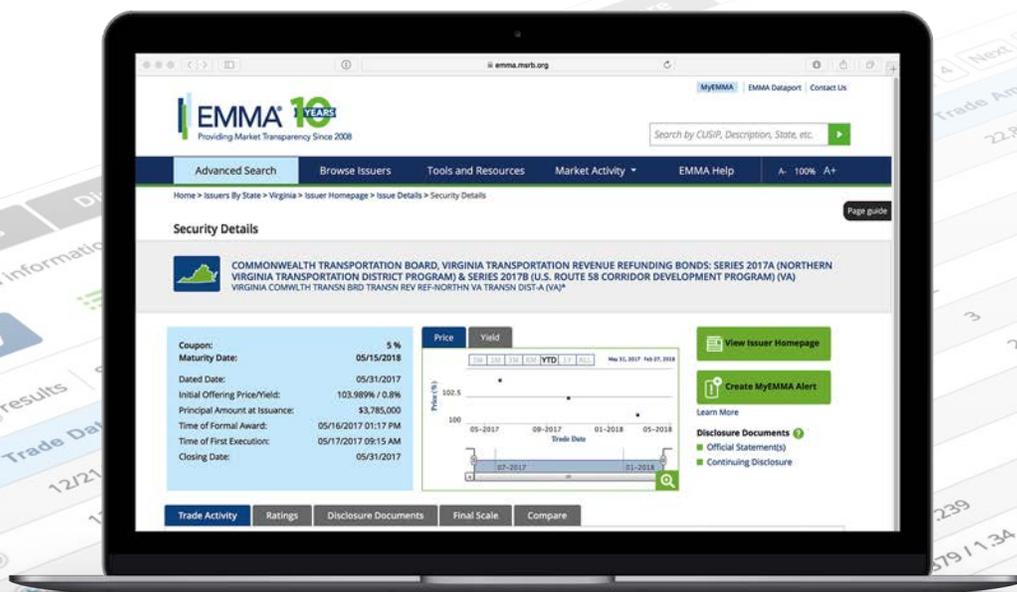
## Investor-Focused Enhancements

In April 2018, the MSRB implemented an enhanced design and improved navigation on the EMMA website to better serve the information needs of today's—and tomorrow's—municipal securities investors and other market participants. Key changes include direct access to an interactive map to search for information about a municipal bond and its issuer by state and enhanced display of information about a specific security, including interactive graphs of trade prices and yields and a searchable listing of important disclosure documents. The changes were informed by extensive user experience research

and input from stakeholders. As a result of MSRB rulemaking designed to enhance transparency of bond pricing, investors began receiving a direct link to the security-specific EMMA webpage on their trade confirmations in May 2018. For first-time viewers, the page includes a transparent overlay that points out key information and tools for investors.

## Interactive Tools and Resources

The MSRB continues to focus on supplementing the documents and data available on EMMA with interactive tools and resources that support investors and others with evaluating



trends in the municipal market. As part of the April 2018 redesign, a new homepage button directs EMMA visitors to free tools and resources such as a calendar listing new bond issuances scheduled to come to market and municipal market yield curves and indices. In 2018, the MSRB added two new callable yield curves to EMMA and continues to explore making additional tools and resources available.

### Reengineering Trade Reporting

While the EMMA website is the public face of market transparency, an important behind-the-scenes system collects real-time trade data from municipal securities dealers for dissemination on EMMA. The MSRB created this trade reporting system in January 2005 and now processes approximately 39,000 trade reports each day for transactions in the more than one million outstanding municipal securities. The MSRB's Real-Time Transaction Reporting System (RTRS)

underwent an intensive modernization that was completed in May 2018 to ensure RTRS is equipped to respond to an evolving municipal market and adapt as needed to future regulatory requirements.

### The Future of Market Transparency

2018 is just the beginning of a new decade in market transparency. The MSRB is looking ahead to the next phase of EMMA enhancements, which will focus on simplifying the document filing process for issuers of municipal securities that rely on EMMA to disclose essential information about their bonds. A third phase of EMMA development will address the needs of municipal industry professionals, particularly advanced search functionality. This work will be aligned with the MSRB's long-term vision and guiding principles for developing EMMA published in November 2017 and will continue to be informed by feedback from stakeholders.



[Take a video tour of EMMA website](#) and watch other EMMA educational videos by following the MSRB's YouTube channel at [MSRB\\_News](#).

### Engaging with EMMA Users



**10**

**user/focus groups** on market transparency initiatives and EMMA



nearly

**750**

online **comments** received on EMMA



“EMMA quite simply revolutionized municipal market transparency. It has become a critical resource for the municipal bond community by offering an extensive, timely and ever-increasing range of municipal securities information. What started as a much-needed centralized document repository has evolved into a one-stop shop for municipal market participants through the addition of trading activity, rating information, new-issue calendars, pre-sale documents and market statistics. Perhaps best of all, EMMA's offerings continually improve through stakeholder input and the dedication of MSRB staff.”

~ Manju S. Ganeriwala, MSRB Board Member  
Treasurer, Commonwealth of Virginia

The MSRB is dedicated to providing resources to ensure municipal securities investors, issuers and market professionals are well-equipped to make educated and sound financial decisions.

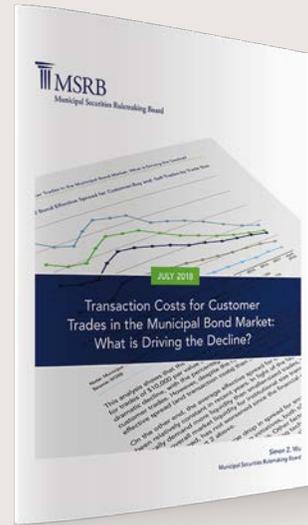
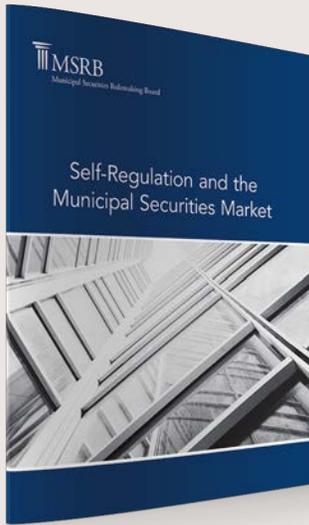
## Leveraging Our Role as an SRO

Regulation of the different securities markets and their participants is grounded largely in the Securities Exchange Act of 1934—established by Congress—which outlines the framework for a regulatory model to promote effective and efficient regulation and oversight of the securities markets. Due to the many intricacies and unique characteristics of the municipal securities market, the MSRB has the specific mandate to protect municipal securities investors, municipal entities and the public interest. Last year, the organization leveraged its role as an SRO and published a report about the history of self-regulation in the municipal securities market. The report details features of the MSRB's distinctive SRO model and provides perspective on the organization's role and jurisdiction

within the municipal market. The SRO model—influenced largely by market expertise, stakeholder feedback, market developments and rigorous government oversight—enables the MSRB to regulate financial intermediaries effectively and provide essential market transparency services to market participants.

The MSRB is dedicated to providing resources to ensure municipal securities investors, issuers and market professionals are well-equipped to make educated and sound financial decisions. The MSRB believes it has the obligation to provide expert analysis and educational resources for public use—and throughout 2018, the MSRB published a variety of market reports.

These publications included the MSRB's annual [Fact Book of municipal securities](#)



[market data](#), and in 2018, an [issue brief on minimum denominations of municipal securities](#) and an [examination of the impact of municipal bond exchange-traded funds on liquidity of the municipal bond market](#). The MSRB’s Chief Economist also examined trends in customer trading activity of municipal securities dealers and published a [report evaluating the steady decline in transaction costs for customer trades in municipal securities since 2005](#).

As an SRO, the MSRB periodically evaluates issues outside of its rulemaking jurisdiction that can

have an impact on market integrity or efficiency. In 2018, the MSRB requested information from market participants and the public on the accessibility, methodology and utility of indices, yield curves and other benchmarks currently available in the municipal market. The purpose of this request for information was to gather insight to help inform and support the organization’s mission to promote a fair and efficient municipal market.

Collaboration and communication were priorities for the MSRB in 2018 and included new forums to encourage

idea sharing. In 2018, a new series of town hall meetings was created to increase engagement with municipal market stakeholders and the Board created the Compliance Advisory Group, discussed further on p. 4.

As an SRO, the MSRB is dedicated to promoting a fair and efficient municipal market. The organization has, and will continue to, prioritize its initiatives around fairness and efficiency as the principal securities regulator of the nation’s \$3.9 trillion municipal securities market.



“ The MSRB’s budget plays an important role in meeting the varying demands of ensuring a fair and efficient municipal marketplace. The MSRB must balance competing mandates while providing the technology to deliver essential market data and information. Revenue is largely tied to market volume and maintaining appropriate reserves is essential in shielding the industry from frequent changes in fee structure.”

~ Jerry W. Ford, MSRB Board Member and Finance Committee Chair President, Ford & Associates, Inc.

## BOARD OF DIRECTORS 2018–2019

### OFFICERS

**Gary Hall**  
*Chair*

**Edward J. Sisk**  
*Vice Chair*

### PUBLIC REPRESENTATIVES



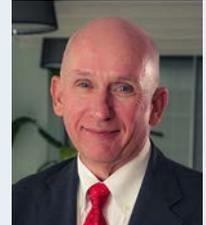
**Robert Clarke Brown**  
*Retired*  
Shaker Heights, Ohio



**Julia H. Cooper**  
*Director of Finance*  
City of San José  
San José, California



**Caroline Cruise**  
*Portfolio Manager*  
Loews Corporation  
New York, New York



**Joseph Darcy**  
*Retired*  
Belle Mead, New Jersey



**Ronald Dieckman**  
*Retired*  
Holly Springs, North  
Carolina



**Richard K. Ellis**  
*Senior Director of  
Compliance and  
Communications*  
Utah Educational  
Savings Plan  
Salt Lake City, Utah



**William M. Fitzgerald, Sr.**  
*Founder*  
Fitzgerald Asset  
Management LLC  
Chicago, Illinois



**Manju S. Ganeriwala**  
*Treasurer*  
Commonwealth of Virginia  
Richmond, Virginia



**Lakshmi Kommi**  
*Director of Debt  
Management*  
City of San Diego  
San Diego, California



**Christopher M. Ryon**  
*Managing Director*  
Thornburg Investment  
Management  
Santa Fe, New Mexico



**Donna Simonetti**  
*Retired*  
Portland, Maine

## SECURITIES FIRM REPRESENTATIVES



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*Managing Director and Head of Public Finance*  
 Piper Jaffray & Co.  
 Minneapolis, Minnesota



**Gary Hall, Chair**  
*Senior Managing Director, National Head of Investment Banking and Equity Partner*  
 Siebert Cisneros Shank & Co., LLC  
 Oakland, California



**Beth Wolchock**  
*Managing Director and Municipal Principal*  
 Oppenheimer & Co. Inc.  
 Stamford, Connecticut

## MUNICIPAL ADVISOR REPRESENTATIVES



**Renee Boicourt**  
*Managing Director and Partner*  
 Lamont Financial Services Corporation  
 Fairfield, New Jersey



**Jerry W. Ford**  
*President*  
 Ford & Associates, Inc.  
 Tampa, Florida



**Seema Mohanty**  
*Founder and Managing Director*  
 Mohanty Gargiulo, LLC  
 New York, New York

## BANK REPRESENTATIVES



**Patrick Brett**  
*Managing Director and Head of Municipal Debt Capital Markets*  
 Citi  
 New York, New York



**Daniel Kiley**  
*Managing Director and Head of Municipal Fixed Income Trading*  
 Wells Fargo  
 St. Louis, Missouri



**Kemp J. Lewis**  
*Senior Managing Director*  
 Raymond James & Associates, Inc.  
 New York, New York



**Edward J. Sisk, Vice Chair**  
*Managing Director, Head of Public Finance*  
 Bank of America  
 Merrill Lynch  
 New York, New York

## MSRB SENIOR MANAGEMENT

**Lynnette Kelly**  
*President and Chief Executive Officer*

**Mark T. Kim**  
*Deputy Executive Director and Chief Operating Officer*

**Michael L. Post**  
*General Counsel*

**John A. Bagley**  
*Chief Market Structure Officer*

**Jennifer A. Galloway**  
*Chief Communications Officer*

**Nanette D. Lawson**  
*Chief Financial Officer*

**Gail Marshall**  
*Chief Compliance Officer*

**Ritta McLaughlin**  
*Chief Education Officer*

**Lanny Schwartz**  
*Chief Regulatory Officer*



## FINANCIAL SUSTAINABILITY

The MSRB is committed to transparency and responsible financial management. In addition to the annual publication of full audited financial statements, financial highlights and the availability of key financial policies on our website, last year the MSRB began publishing a budget summary at the beginning of the fiscal year. Taken together, this information provides an opportunity for stakeholders and municipal market participants to better understand the organization's finances and how we manage resources in support of our mission. It is important for stakeholders to understand that the MSRB must be positioned financially to carry out its statutory mission under all market conditions, including in 2018 with the transition experienced by the industry following federal tax reform.

In 2018, the MSRB continued its commitment to advancing its goals of fair and equitable fees, diversification of revenues and strict management of expenses, among other priorities, as described below and reflected in the financial highlights and disclosed in the audited financial statements. To further advance our strategic goal of ensuring fair and equitable fees, the MSRB in 2018 increased the annual municipal advisor professional fee to \$500 from \$300. Municipal advisors have been paying the annual professional fee since 2014 and the recent increase helps defray the expenses of operating the MSRB—especially those activities associated with the regulation of municipal advisors. We also continued efforts to diversify revenue sources by assessing a new annual fee in 2018 on dealers acting as underwriters to 529 plans, which are municipal fund securities. The new underwriting fee recognizes the benefits these dealers receive from a fair and efficient market supported by MSRB rules and access to the MSRB's transparency systems, and helps support the MSRB's costs of operating and administering rulemaking, market transparency and educational activities. Ensuring fair and equitable fees remains top-of-mind for the Board and staff, and fees are a regular source of discussion and evaluation as we seek to balance resource needs and funding sources.

Consistent with the Board's stated approach to monitor and manage organizational reserve levels and in conjunction with the 2019 budget, a summary of which was published in October 2018, the Board in 2018 agreed to temporarily reduce the assessment rates for underwriting, transaction and technology fees related to market activity during the last three months of calendar year 2018—the first quarter of fiscal year 2019. In 2018, the Board also designated \$5 million of reserves for strategic investment in positioning the MSRB's information technology infrastructure for the future, including funding exploration and potential transition to cloud computing. Maintaining the MSRB's six market transparency systems, including the EMMA website and the Real-Time Transaction Reporting System, which receives, processes and disseminates market-critical data and documents 24 hours a day, seven days a week, remains a key focus for the MSRB.

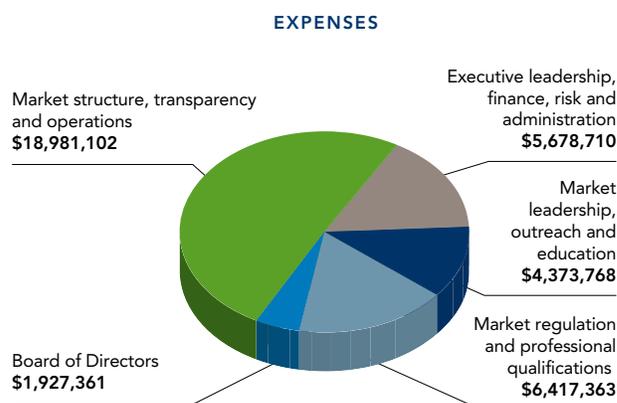
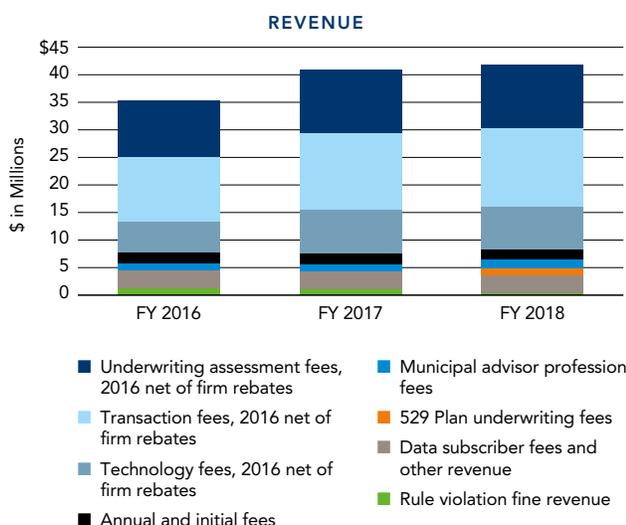
As part of its 2019 priorities, the Board is reviewing the organization's reserve target and assessing whether any changes should be made. It is also evaluating the MSRB's data subscription pricing model as part of its effort to diversify funding sources and promote the organization's financial sustainability. The MSRB remains committed to public accountability and demonstrating the alignment between its financial resources, mission and strategic goals.

Sincerely,

A handwritten signature in blue ink that reads 'Lynnette Kelly'. The signature is written in a cursive, professional style.

Lynnette Kelly, President and Chief Executive Officer

## FINANCIAL HIGHLIGHTS



September 30	2018	2017	2016
<b>Statements of Financial Position</b>			
Total Assets	\$ 88,567,608	\$ 84,511,116	\$ 79,547,955
Total Liabilities	9,752,147	10,074,504	10,233,151
Total Net Assets — Unrestricted	78,815,461	74,436,612	69,314,804
<b>Statements of Activities</b>			
<b>Revenue:</b>			
Underwriting assessment fees, net of firm rebates of \$1.8 million in 2016	11,567,664	11,629,582	10,367,501
Transaction fees, net of firm rebates of \$2.2 million in 2016	14,192,475	13,889,042	11,632,218
Technology fees, net of firm rebates of \$1.5 million in 2016	7,733,728	7,950,238	5,576,543
Annual and initial fees	1,883,586	2,024,234	2,144,609
Municipal advisor professional fees	1,578,100	1,196,700	1,225,200
529 Plan underwriting fees	1,292,504	—	—
Data subscriber fees and other revenue	3,191,304	3,270,845	3,221,828
Rule violation fine revenue	317,792	994,738	1,219,081
Total Revenue	41,757,153	40,955,379	35,386,980
<b>Expenses</b>	37,378,304	35,833,571	35,587,170
<b>Change in Net Assets</b>	\$ 4,378,849	\$ 5,121,808	\$ (200,190)
<b>Statements of Cash Flows</b>			
Cash Provided from Operating Activities	\$ 8,628,701	\$ 9,452,952	\$ 9,486,966
Cash Investment in Technology Systems and Other Fixed Assets	\$ 4,428,947	\$ 5,132,018	\$ 8,826,669



## Report of Independent Auditors

To the Board of Directors of  
The Municipal Securities Rulemaking Board

We have audited the accompanying financial statements of the Municipal Securities Rulemaking Board (the MSRB), which comprise the statements of financial position as of September 30, 2018 and 2017 and the related statements of activities and of cash flows for the years then ended.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the MSRB's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the MSRB's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the MSRB as of September 30, 2018 and 2017 and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "PricewaterhouseCoopers up". The signature is written in a cursive, flowing style.

December 14, 2018

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PricewaterhouseCoopers LLP, 1800 Tysons Boulevard, McLean, VA 22102  
T: 703 918 3000, [www.pwc.com](http://www.pwc.com)

## FINANCIAL STATEMENTS

### STATEMENTS OF FINANCIAL POSITION

<i>As of September 30, 2018 and 2017</i>	2018	2017
<b>ASSETS</b>		
Cash and cash equivalents	\$ 1,675,923	\$ 1,864,342
Accounts receivable — net	5,483,311	5,596,140
Prepaid and other assets	1,459,687	1,460,666
Accrued interest receivable	261,524	272,844
Investments	65,768,775	61,803,743
Fixed assets — net	13,918,388	13,513,381
<b>TOTAL ASSETS</b>	<b>\$88,567,608</b>	<b>\$84,511,116</b>
<b>LIABILITIES AND NET ASSETS</b>		
Accounts payable and accrued liabilities	\$ 1,982,828	\$ 1,937,170
Accrued vacation payable	788,514	705,729
Deferred revenue	304,454	250,648
Deferred compensation	—	270,248
Deferred rent	6,676,351	6,910,709
Total liabilities	9,752,147	10,074,504
Undesignated net assets	71,827,402	67,811,054
Designated, cloud fund	4,980,464	—
Designated, technology renewal fund	2,007,595	6,625,558
Net assets — unrestricted	78,815,461	74,436,612
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$88,567,608</b>	<b>\$84,511,116</b>

The accompanying notes are an integral part of these financial statements.

## STATEMENTS OF ACTIVITIES

*For the years ended September 30, 2018 and 2017*

	2018	2017
<b>REVENUE:</b>		
Underwriting assessment fees	\$11,567,664	\$11,629,582
Transaction fees	14,192,475	13,889,042
Technology fees	7,733,728	7,950,238
Annual and initial fees	1,883,586	2,024,234
Data subscriber fees	2,164,411	1,882,413
Municipal advisor professional fees	1,578,100	1,196,700
529 plan underwriting fees	1,292,504	–
Rule violation fine revenue	317,792	994,738
Other income	1,026,893	1,388,432
<b>Total Revenue</b>	<b>41,757,153</b>	<b>40,955,379</b>
<b>EXPENSES:</b>		
Market regulation and professional qualifications	6,417,363	7,549,784
Board of Directors	1,927,361	1,642,087
Market structure, transparency and operations	18,981,102	17,550,521
Market leadership, outreach and education	4,373,768	3,336,510
Executive leadership, finance, risk and administration	5,678,710	5,754,669
<b>Total Expenses</b>	<b>37,378,304</b>	<b>35,833,571</b>
<b>CHANGE IN NET ASSETS</b>	<b>4,378,849</b>	<b>5,121,808</b>
<b>NET ASSETS — Beginning of year</b>	<b>74,436,612</b>	<b>69,314,804</b>
<b>NET ASSETS — End of year</b>	<b>\$78,815,461</b>	<b>\$74,436,612</b>

The accompanying notes are an integral part of these financial statements.

## STATEMENTS OF CASH FLOWS

For the years ended September 30, 2018 and 2017

	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Change in net assets	\$4,378,849	\$5,121,808
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	4,157,031	4,133,849
Net loss on disposal of long-lived assets	67,070	58,882
Unrealized loss on investments	343,748	363,522
Net amortization of investment premiums and discounts	85,679	157,166
Realized (gain) loss on investments	(6,286)	1,901
Bad debt expense	-	105,255
Changes in assets and liabilities:		
Accounts receivable	112,829	159,522
Prepaid and other assets	979	(434,336)
Accrued interest receivable	11,320	(55,970)
Accounts payable and accrued liabilities	(154,503)	(1,321,035)
Accrued vacation payable	82,785	22,634
Deferred revenue	53,806	(27,562)
Deferred compensation	(270,248)	129,443
Deferred rent	(234,358)	1,037,873
<b>Net cash provided by operating activities</b>	<b>8,628,701</b>	<b>9,452,952</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of long-lived assets	(4,428,947)	(5,132,018)
Purchases of investments	(28,275,469)	(23,238,858)
Maturities of investments	23,887,296	17,030,000
<b>Net cash used in investing activities</b>	<b>(8,817,120)</b>	<b>(11,340,876)</b>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(188,419)</b>	<b>(1,887,924)</b>
<b>CASH AND CASH EQUIVALENTS, Beginning of year</b>	<b>1,864,342</b>	<b>3,752,266</b>
<b>CASH AND CASH EQUIVALENTS, End of year</b>	<b>\$1,675,923</b>	<b>\$1,864,342</b>
<b>SCHEDULE OF NONCASH INVESTING ACTIVITIES</b>		
Accrual of office equipment and software purchases	\$ 200,161	\$ -
Like-kind equipment exchange	\$ 3,500	\$ 2,500

The accompanying notes are an integral part of these financial statements.

# NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2018 AND 2017

## 1. NATURE OF OPERATIONS

The Municipal Securities Rulemaking Board (MSRB) was created by Congress under the 1975 Amendments to the Securities Exchange Act of 1934, and the authority of the MSRB was expanded by further amendments to the Exchange Act under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (as amended, the Exchange Act). The MSRB is incorporated as a not-for-profit, non-stock corporation pursuant to the laws of the Commonwealth of Virginia. Under the Exchange Act, the MSRB is a self-regulatory organization with authority to adopt rules regulating the municipal securities activities of brokers, dealers and municipal securities dealers, and the municipal advisory activities of municipal advisors (collectively referred to as “regulated entities”), to promote fair and efficient markets and to protect investors, municipal entities, obligated persons and the public interest. The MSRB collects and disseminates market information, operates the Electronic Municipal Market Access (EMMA<sup>®</sup>) website to promote transparency and widespread access to information, and also engages in significant education, outreach and market leadership activities.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Accounting** — The MSRB’s financial statements are prepared using the accrual basis of accounting in accordance with the accounting principles generally accepted in the United States of America (GAAP).

**Fair Value Measurement** — The MSRB measures fair value in accordance with the provisions of Financial Accounting Standards Board (FASB) ASC 820, Fair Value Measurement, which provides a common definition of fair value for GAAP and International Financial Reporting Standards (IFRS), establishes a framework for measuring fair value, provides a fair value hierarchy based on the quality of inputs used to measure fair value and enhances disclosure requirements.

**Cash Equivalents** — Highly liquid investments with maturities of three months or less at the date of purchase are considered to be cash equivalents.

Included in cash equivalents are short term money market mutual funds fully invested in securities backed by the full faith and credit of the United States (U.S.) Government with a total fair market value of approximately \$0.6 million and \$1.1 million at September 30, 2018 and 2017, respectively.

**Investments** — Investments are stated at fair value. Investments consist of U.S. Treasury notes, obligations of U.S. Government sponsored enterprises that are fully guaranteed by the U.S. Government, certificates of deposit that are FDIC insured and in 2017, a 457(f) Rabbi Trust that is comprised entirely of mutual funds.

Amortization and accretion of investment premiums and discounts are recorded as a component of investment return.

**Accounts Receivable and Allowance for Doubtful Accounts** — Accounts receivable are recorded at invoiced amounts and do not bear interest. Accounts receivable are reported net of an allowance for doubtful accounts in the statements of financial position. Management’s estimate of the allowance for doubtful accounts is based on historical collection experience and ongoing account reviews. Account balances are written off against the allowance once the potential for recovery is considered remote.

**Concentration of Credit Risk** — Financial instruments that potentially subject the MSRB to a concentration of credit risk consist principally of cash, cash equivalents, accounts receivable and investments. The MSRB maintains cash primarily in non-interest-bearing accounts with FDIC insurance up to \$250,000. MSRB investments are backed by the full faith and credit of the U.S. Government or its fully guaranteed government sponsored enterprises. Accounts receivable consist of fees due from regulated entities and data subscribers. At times, there are certain significant balances due from regulated entities but the MSRB does not believe it is exposed to any significant credit risk on these balances. Five regulated entities accounted for approximately one-third of total fee revenue in fiscal year 2018 and fiscal year 2017.

**Use of Estimates** — The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used in accounting for, among other things, realization of accounts receivable, the carrying value of investments and the impairment of long-lived assets. Actual results could differ from those estimates.

**Fixed Assets** — Computer and office equipment, as well as furniture and fixtures are recorded at cost and are depreciated using the straight-line method over three years and five years, respectively. Acquisition costs include all expenses necessary to prepare the asset for its intended purpose including direct labor related costs. Leasehold improvements are amortized using the straight-line method over the shorter of the remaining lease period or the estimated useful life of the improvement. Improvements and replacements of fixed assets are capitalized. Maintenance and repairs that do not improve or extend the lives of fixed assets are charged to expense as incurred.

When assets are sold or retired, their cost and related accumulated depreciation are removed from the accounts, and any gain or loss is recognized in the statements of activities.

**Capitalized Software Costs** — The MSRB capitalizes certain costs associated with computer software developed or obtained for internal use as part of the MSRB information systems. The MSRB's policy provides for the capitalization of external direct costs of materials and services and direct payroll-related costs incurred during the application development stage as well as costs related to upgrades and enhancements to this software provided it is probable that these expenditures will result in additional functionality. Costs associated with preliminary project stage activities, training, maintenance and post implementation stage activities are expensed as incurred.

After all substantial testing and deployment are completed and the software is ready for its intended use, internally developed software costs are amortized using the straight-line method over three or five years, depending upon the expected useful life.

**Impairment of Long-Lived Assets** — The MSRB's policy is to review its long-lived assets, such as fixed assets and capitalized software costs, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment, if any, is recognized in the period of identification to the extent the carrying amount of an asset exceeds the fair value of such asset.

**Leases** — The MSRB leases office space under non-cancelable operating leases and may include options that permit renewals for additional periods. Rent abatements and escalations are considered in the determination of straight-line rent expense for operating leases. Lease incentives are recorded as deferred rent and recognized as a reduction to rent expense on a straight-line basis over the lease term.

**Deferred Revenue** — Data Subscriber revenue is recognized on a straight-line basis over the service period. Deferred revenue represents the portion of payments received applicable to future periods.

**Functional Allocation of Expenses** — The costs of providing the various organizational activities and programs have been summarized on a functional basis in the statements of activities. Accordingly, certain costs have been allocated among the programs benefitted.

**Reciprocal Transactions** — The MSRB receives municipal credit ratings data for municipal securities in exchange for its data subscription service feeds. The revenue and expenses are recognized in the Statement of Activities at the same data subscription fee rate that other data subscribers pay for similar services. Revenue and expenses recognized totaled \$132,000 for the years ended September 30, 2018 and September 30, 2017.

## Revenue Recognition:

*Underwriting Assessment Fees* — The underwriting assessment fee on municipal securities dealers acting as underwriters is required to be paid per Rule A-13 and is equal to \$0.0275 per \$1,000 of the par value of municipal securities purchased by underwriters from an issuer as part of a new issue.

Revenue from underwriting assessment fees is recognized in the month the underwriter files the offering document with the MSRB.

*Transaction Fees* — The transaction fee on municipal securities dealers is required to be paid per Rule A-13 and is \$0.01 per \$1,000 par value of bonds sold and is levied on both customer and interdealer transactions as specified in Rule A-13. As described in this rule, certain transactions are exempt from this fee.

Transaction fee revenue is recognized as sales transactions are settled.

*Technology Fees* — The technology fee on municipal securities dealers is required to be paid per Rule A-13 and is \$1.00 per municipal security trade for all customer and interdealer sales transactions.

Technology fee revenue is recognized as sales transactions are settled.

*Data Subscriber Fees* — For a fee, the MSRB provides access to four electronic information systems that collect, store and provide information pertaining to the municipal securities market. The MSRB Primary Market Disclosure System includes official statements, advance refunding documents and related data. The MSRB Continuing

Disclosure System includes continuing disclosure documents and related data from municipal securities issuers, obligated persons and their agents. The Real Time Transaction Reporting System covers data on all municipal securities transactions for purposes of price transparency and surveillance. Finally, the Short-term Obligation Rate Transparency System covers short-term obligation rate reset data and related documents. Information processed by these systems is sold to subscribers on an annual basis with revenue recognized straight-line over the period of service. In addition, the MSRB sells annual historical collections of information from these systems, with the fee billed and recognized at the time of purchase.

*Municipal Advisor Professional Fees* — Each municipal advisor that is registered with both the SEC and the MSRB is required to pay an annual per professional fee of \$500 per Rule A-11, effective April 2018. Prior to April 2018, the annual per professional fee was \$300.

*529 Plan Underwriting Fees* — Beginning in fiscal year 2018, underwriters to 529 college savings plans must pay an annual fee of \$.005 per \$1,000 of the total aggregate plan assets as of December 31 of each year as reported on MSRB Form G-45, and as required to be paid per Rule A-13.

*Annual and Initial Fees* — With respect to each fiscal year of the MSRB in which a regulated entity conducts business, the regulated entity is required to pay an annual fee of \$1,000 per Rule A-12. Revenue is recognized when regulated entities are billed annually in October, or when received upon initial registration with the MSRB to conduct business. The initial fee is a one-time fee of \$1,000 which is to be paid by every regulated entity upon registration with the MSRB under Rule A-12. Initial fee revenue is recognized when received.

*Rule Violation Fee Revenue* — The Dodd-Frank Act provides that fines collected by the Securities and Exchange Commission (SEC) for violations of the rules of the MSRB shall be equally divided between the SEC and the MSRB, and that one-third of fines collected by the Financial Industry Regulatory Authority (FINRA) allocable to violations of the rules of the MSRB will be paid to the MSRB, although the portion of such fines payable to the MSRB may be modified at the direction of the SEC upon agreement between the MSRB and FINRA. Fine revenue is recorded in the month earned.

*Professional Qualification Examination Fees* — Rule A-16 establishes the examination fee on persons taking certain qualification examinations of \$150 per exam. These examinations include the Series 50 (Municipal Advisor Representative Qualification Examination), Series 51 (Municipal Fund Securities Limited Principal Qualification Examination), Series 52 (Municipal Securities

Representative Qualification Examination) and Series 53 (Municipal Securities Principal Qualification Examination).

Professional qualification examination fees are recognized in the month the exams are given and totaled \$384,300 and \$623,700 for the years ended September 30, 2018 and 2017, respectively. Professional qualification examination fees are included in other income in the accompanying statements of activities.

## **New Accounting Pronouncements:**

In August 2018, the FASB issued Accounting Standards Update (ASU) 2018-15 – Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 250-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract. The amendments in this update align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). This standard is effective for the fiscal year ending September 30, 2021. The amendments should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. The MSRB believes adoption of this standard will not have a significant impact on the statements of financial position, statements of activities or cash flows.

In March 2017, the FASB issued Accounting Standards Update (ASU) 2017-08: Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The amendments in this ASU shorten the amortization period for certain callable debt securities held at a premium and require the premium to be amortized to the earliest call date. Securities held at a discount continue to be amortized to maturity. This standard is effective for the fiscal year ending September 30, 2020, with early adoption permitted. The MSRB elected early adoption of this standard. The amendments should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to unrestricted net assets as of the beginning of the period of adoption. In addition, adoption of the amendments should be disclosed as a change in accounting principle. Fiscal year 2017 is the first year the MSRB was approved to invest in callable U.S. Government sponsored agency securities. As a result, there is no cumulative-effect adjustment from the early adoption and the change in accounting principle did not have a significant impact on the financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which supersedes the guidance in

former Accounting Standards Codification (ASC) (Topic 840) Leases. The most significant change will result in the recognition of lease assets for the right to use the underlying asset, and lease liabilities for the obligation to make lease payments by lessees, for those leases classified as operating leases under current guidance. The new guidance will also require significant additional disclosures about the amount, timing and uncertainty of cash flows from leases. This standard is effective for the fiscal year ending September 30, 2021, with early adoption permitted. Upon adoption of ASU 2016-02, entities are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The MSRB believes adoption of this standard will have a significant impact on the statements of financial position and will not have a significant impact on the statements of activities and cash flows.

In August 2016, the FASB issued ASU 2016-14 to Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities. The ASU amends several requirements for financial statements and notes, including net asset classifications in the statements of financial position and statements of activities and enhanced disclosures in numerous areas. This standard is effective for the fiscal year ending September 30, 2019, with early adoption permitted. The MSRB is evaluating the impact this ASU will have on the financial statement presentation.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows. This standard is effective for the fiscal year ending September 30, 2019, with early adoption permitted. The MSRB is evaluating the impact this ASU will have on the financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The guidance in this update supersedes the revenue recognition requirements in Topic 605 explaining that an entity should recognize revenue to depict the transfer of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, FASB issued ASU No. 2015-14, Deferral of the Effective Date, to defer the original effective date prescribed by ASU No. 2014-09. These standards are now effective for the fiscal year ending September 30, 2020. The MSRB believes adoption of this standard will not have a significant impact on the financial statements.

### 3. INVESTMENTS

Investments as of September 30, 2018 and 2017, consist of the following:

	2018	2017
Government-guaranteed agency securities	\$28,016,696	\$34,055,879
U.S. treasury notes	27,416,955	16,108,027
Certificates of deposit	10,335,124	11,369,211
Mutual funds — target date index fund	–	270,626
	<b>\$65,768,775</b>	<b>\$61,803,743</b>

Government-guaranteed agency securities include Federal National Mortgage Association and Federal Home Loan Mortgage Corporation bonds, government sponsored enterprises fully guaranteed by the U.S. Government.

In September 2014, a letter of credit in the amount of \$130,000 was accepted as a security deposit by the landlord under the terms of the new office lease in Washington, D.C. The MSRB purchased a certificate of deposit for the same amount to collateralize the letter of credit. This holding is included in certificates of deposit and is valued at \$133,296 as of September 30, 2018 and 2017.

Investment return for the years ended September 30, 2018 and 2017 is included in other income in the accompanying statements of activities and consists of the following:

	2018	2017
Interest and dividends	\$839,337	\$664,541
Unrealized losses	(343,748)	(363,522)
Realized gains (losses)	6,286	(1,901)
	<b>\$501,875</b>	<b>\$299,118</b>

#### 4. FAIR VALUE MEASUREMENTS

The carrying amounts of financial instruments, including cash, receivables, accounts payable and accrued expenses, approximate fair value as of September 30, 2018 and 2017 because of the relatively short duration of these instruments.

The MSRB's policy uses the GAAP framework for measuring fair value which provides a fair value hierarchy based on observable inputs. Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect assumptions that market participants would use in pricing the asset or liability based on the best information available in the circumstances. The hierarchy reflects three levels based on the transparency of inputs as follows:

*Level 1* — Valuation based on quoted prices available in active markets for identical assets or liabilities as of the report date.

*Level 2* — Valuations based on inputs, other than quoted prices included within Level 1, that are observable, either directly or indirectly.

*Level 3* — Valuations based on significant inputs that are unobservable and reflect management's best estimate of what market participants would use as fair value.

The MSRB considers observable market data to be readily available, regularly distributed or updated, reliable and verifiable, not proprietary and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to the entity's perceived risk of that instrument.

The MSRB's Level 1 investments include mutual funds.

The MSRB's Level 2 investments include U.S. treasury notes, obligations of U.S. government sponsored enterprises fully guaranteed by the U.S. Government and certificates of deposit.

The MSRB bases the fair value on pricing obtained from the MSRB's investment brokers. The MSRB does not adjust for or apply any additional assumptions or estimates to the pricing information it receives from its brokers. The brokers' pricing is compared to industry standard data providers or current yields available on comparable securities for reasonableness. The MSRB considers this the most reliable information available for the valuation of investments.

Investments were recorded at fair value as of September 30, 2018 and 2017, based on the following levels of hierarchy:

2018	Level 1	Level 2	Level 3	Total
Government-guaranteed agency securities	\$ –	\$28,016,696	\$ –	\$28,016,696
U.S. treasury notes	–	27,416,955	–	27,416,955
Certificates of deposit	–	10,335,124	–	10,335,124
	\$ –	\$65,768,775	\$ –	\$65,768,775

2017	Level 1	Level 2	Level 3	Total
Government-guaranteed agency securities	\$ –	\$34,055,879	\$ –	\$34,055,879
U.S. treasury notes	–	16,108,027	–	16,108,027
Certificates of deposit	–	11,369,211	–	11,369,211
Mutual funds	270,626	–	–	270,626
	\$270,626	\$61,533,117	\$ –	\$61,803,743

## 5. ACCOUNTS RECEIVABLE

Accounts receivable as of September 30, 2018 and 2017 consist of the following:

	2018	2017
Billed accounts receivable	\$3,897,899	\$4,077,607
Unbilled accounts receivable	1,695,219	1,656,461
	5,593,118	5,734,068
Less allowance for doubtful accounts	(109,807)	(137,928)
	\$5,483,311	\$5,596,140

Unbilled receivables at September 30, 2018 and 2017 consist primarily of September transaction and technology fees revenue billed in early November.

## 6. PREPAID AND OTHER ASSETS

Prepaid and other assets as of September 30, 2018 and 2017 consist of the following:

	2018	2017
Prepaid assets	\$1,454,307	\$1,449,651
Deposits	5,380	11,015
	\$1,459,687	\$1,460,666

## 7. FIXED ASSETS

Fixed assets as of September 30, 2018 and 2017 consist of the following:

	2018	2017
Capitalized software costs	\$33,601,376	\$35,040,036
Computer and office equipment	5,286,546	5,009,614
Leasehold improvements	4,051,796	4,040,651
Furniture and fixtures	1,704,212	1,713,424
	44,643,930	45,803,725
Less accumulated depreciation and amortization:		
Capitalized software costs	(24,288,882)	(27,479,390)
Computer and office equipment	(4,583,012)	(3,593,878)
Leasehold improvements	(872,820)	(567,601)
Furniture and fixtures	(980,828)	(649,475)
	(30,725,542)	(32,290,344)
	\$13,918,388	\$13,513,381

Depreciation expense and amortization expense during fiscal years 2018 and 2017 are as follows:

	2018	2017
Depreciation expense	\$1,374,759	\$1,641,730
Amortization expense for capitalized software cost and leasehold improvements	2,782,272	2,492,119
	\$4,157,031	\$4,133,849

**Impairment of long-lived assets** — Through regular review of long-lived assets, in fiscal year 2018 and 2017 no estimated impairment loss was recognized.

**Leasehold improvements** — In conjunction with the Washington, D.C. lease, the landlord provided up to \$4.4 million in landlord incentives, of which \$4.03 million funded leasehold improvements, and \$323,000 offset future rent payments.

**Capitalized software costs** — For the years ended September 30, 2018 and 2017, \$0.8 million and \$4.1 million, respectively, of internally developed work-in-process costs for software not yet implemented are included in capitalized software costs.

## 8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of September 30, 2018 and 2017 consist of the following:

	2018	2017
Accounts payable and accrued expenses	\$1,351,555	\$1,294,129
Salaries, taxes and benefits payable	631,273	643,041
	<u>\$1,982,828</u>	<u>\$1,937,170</u>

## 9. COMMITMENTS AND CONTINGENCIES

**Operating Leases** — The MSRB leases office space under operating lease arrangements. The MSRB moved to new office space in Washington, D.C. in December 2015 and the lease will expire in fiscal year 2031.

The D.C. lease contains an escalation clause based on increases in rent and building operating costs. Rent expense is recognized on a straight-line basis over the term of the respective lease and is credited or charged to deferred rent as appropriate, which is included in liabilities in the accompanying statements of financial position. Total rent expense for operating leases for the years ended September 30, 2018 and 2017 was \$2,280,826 and \$1,794,770, respectively.

The MSRB has lease agreements for website hosting, business continuity and disaster recovery. Total lease payments under these operating leases for the years ended September 30, 2018 and 2017, were \$464,871 and \$472,279, respectively.

Future minimum lease payments under non-cancelable operating leases are as follows:

<b>Years Ending September 30</b>	
2019	\$ 1,935,257
2020	1,695,466
2021	1,737,833
2022	1,781,172
2023	1,825,677
2024 and beyond	15,223,238
Total minimum lease payments	<u>\$24,198,643</u>

**Employment Agreements** — In accordance with the chief executive officer's employment agreement, a 457(f) deferred compensation plan was maintained and annual contributions as defined by the agreement were made. Contributions and the related earnings and interest vest at certain interval dates. In fiscal year 2018, the chief executive officer's employment agreement was revised requiring early vesting and payout. As of September 30, 2018, and 2017, the MSRB has recorded a deferred compensation liability related to the 457(f) plan of \$0 and \$270,248, respectively.

## 10. RETIREMENT PLAN

The MSRB has a defined contribution retirement plan for all employees. Participation commences upon date of hire as described in the plan document. For all active participants employed on the first day of the calendar quarter, the MSRB makes a quarterly contribution as required by the plan document. The contribution percentage ranges from 7% to 9% depending on the length of vested service as set forth in the plan document.

Each employee is fully vested upon being credited with three plan years of service. Employees may also make voluntary contributions to the plan. The MSRB made contributions to the plan totaling \$1,130,047 and \$1,081,450 for the years ended September 30, 2018 and 2017, respectively.

All administrative expenses of the plan are paid by the MSRB. Administrative expenses total \$5,568 and \$4,937 for the years ended September 30, 2018 and 2017, respectively.

## 11. INCOME TAXES

The MSRB is exempt from federal and state taxes on income (other than unrelated business income) under Section 501(c)(6) of the Internal Revenue Code and applicable income tax regulations of the Commonwealth of Virginia and District of Columbia. The MSRB files an annual informational tax form, Form 990, with the Internal Revenue Service. The MSRB realized no unrelated business income in fiscal years 2018 and 2017 and no provision for income taxes has been made as of September 30, 2018 and 2017.

New Internal Revenue Code Section 512(a)(7) changes that began January 1, 2018 require tax-exempt organizations to increase unrelated business taxable income for qualified transportation benefits provided to their employees. Uncertainty remains in the benefits that will be subject to the tax. The MSRB estimates the 2018 possible tax liability at a range between approximately \$10,000 and \$28,000. Due to the uncertainty and

immateriality, the estimated contingency has not been recognized.

The MSRB addresses uncertain tax positions in accordance with ASC Topic 740, Income Taxes, which provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in financial statements. During the years from 2015 to 2018, which represent the years management considers to be open for examination by taxing authorities, management did not identify the existence of any uncertain tax position.

## 12. BOARD DESIGNATED NET ASSETS

In conjunction with the fiscal year 2019 budget which was approved in July 2018, the Board approved a \$5 million designation of fiscal year 2018 reserve funds for exploration of and potential transition to the Cloud.

With the establishment of the technology fee on January 1, 2011, a Board designated technology renewal fund was created to provide funds for capital expenditures, such as the replacement or acquisition of computer hardware and software. The technology renewal fund is depleted by information technology capital expenses.

	2018	2017
Designated, cloud fund - balance beginning of year	\$ -	\$ -
Board designation	5,000,000	-
Cloud exploration spend	(19,536)	-
Designated, cloud fund	4,980,464	-
Designated, technology renewal fund - balance beginning of year	6,625,558	11,750,777
Technology capital expenditures	(4,617,963)	(5,125,219)
Designated, technology renewal fund	2,007,595	6,625,558
Total Board designated net assets	\$6,988,059	\$6,625,558

## 13. SUBSEQUENT EVENTS

The MSRB evaluated its September 30, 2018 financial statements for subsequent events through December 14, 2018, the date the financial statements were available to be issued. The MSRB is not aware of any subsequent events that would require recognition or disclosure in the financial statements.

In conjunction with the fiscal year 2019 budget, and consistent with the Board's stated approach to monitor and manage organizational reserve levels, the Board temporarily reduced (by approximately 33%) the rate of assessment for municipal securities dealers' underwriting, transaction and technology fees related to market activity during the last three months of calendar year 2018.



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