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MSRB Proposes Amendments to Strengthen Provisions in Supervisory Rules; ICI Requests Comments by May 15th

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19992] May 2, 2006 TO: 529 PLAN ADVISORY COMMITTEE No. 7-06 529 PLAN MEMBERS No. 5-06 RE: MSRB PROPOSES AMENDMENTS TO STRENGTHEN PROVISIONS IN SUPERVISORY RULES; ICI REQUESTS COMMENTS BY MAY 15TH The Municipal Securities Rulemaking Board (MSRB) has proposed revisions to its rules relating to the supervisory control procedures of municipal securities dealers.* The proposed amendments, which are intended to conform the MSRB's supervisory rules to similar rules of the NASD and NYSE regarding their members' supervisory obligations, revise MSRB Rule G-27 to modify the rule's provisions governing supervisory systems to include provisions relating to: □ Designation of offices and assignment of representatives to supervisory personnel; □ Tape recording of conversations in certain circumstances; □ Updating written supervisory procedures; □ Internal inspections; and □ Supervisory control systems. Each of these proposed provisions is briefly summarized below. Comments on the proposal are due to the MSRB no later than Thursday, June 8, 2006. Please provide any comments you have on the proposal to the undersigned no later than Monday, May 15th. Comments should be provided by phone (202-326-5825), fax (202-326-5839) or email (tamara@ici.org). Designation of Offices; Assignment of Representatives The MSRB has proposed to revise subsection (b) of Rule G-37 to add provisions requiring: * See Request for Comment on Draft Amendments to Rule G-27, on Supervisory, that Strengthen Supervisory Procedures, MSRB Notice 2006-11 (April 21, 2006), which is available at: <http://www.msrb.org/msrb1/whatsnew/2006-11.asp>. 2 □ Designation of certain locations as offices of supervisory jurisdiction ("OSJs"); □ Designation of one or more appropriately registered principals in each OSJ, including the main office, and one or more appropriately registered representatives or principals in each non-OSJ branch office with authority to carry out the supervisory responsibilities assigned to that office by the dealer; □ Assignment of each registered person to an appropriately registered representative or principal who is responsible for supervising that person's activities; □ Reasonable efforts to determine that all supervisory personnel are qualified by virtue of experience or training to carry out their assigned responsibilities; and □ Participation of each registered representative and principal in an annual meeting to discuss compliance matters. The rule would expressly affirm that municipal fund securities limited principals are qualified to exercise the supervisory authority of a principal, but solely with respect to activities related

to municipal fund securities. Tape Recording of Conversations The proposed amendments incorporate NASD Rule 3010(b)(2), relating to tape recording of conversations, in Rule G-27. Accordingly, the rule would require a dealer to establish specific supervisory procedures, including the tape recording of conversations, when it hires more than a specified percentage of registered persons from certain firms that have been expelled or had their broker/dealer registrations revoked for violations of sales practice rules. The “specified percentages” in the rule range from 40% for smaller dealers to 20% for larger dealers. Dealers that receive notice from their regulator of a duty to tape record conversations would also have a duty to establish reasonable procedures for reviewing tape recordings, to retain and catalog the tapes, and to submit reports to the appropriate regulator on the dealer’s supervision of the representatives’ telemarketing activities. Updating Written Supervisory Procedures Rule G-27(e) would be revised and renamed as subsection (c)(iii) of the rule. As revised, this provision more closely tracks NASD Rule 3010(b), relating to written supervisory procedures. It would require each dealer to amend its supervisory procedures within a reasonable time after changes occur, rather than as necessary, which is the current standard governing revisions. Internal Inspections Added to Rule G-37 as subsection (d) is a provision, similar to the internal inspection provision in NASD Rule 3010(c). It would require dealers to establish minimum inspection cycles and conduct regular office inspections. It delineates the topics that must be covered during such inspections, defines who is eligible to conduct the inspections, and specifies the manner in which they are to be 3 documented. Dealers would also be required to inspect non-branch locations “on a regular periodic schedule,” to document how it determined such schedule, and to utilize “heightened” inspection procedures in certain circumstances. Supervisory Control Systems A new subsection (f) would be added to the rule to track NASD Rule 3012 relating to supervisory control systems. As proposed, dealers would be required, among other things, to designate one or more principals to test and verify the dealer’s supervisory control procedures. The designated principals must also provide a report, at least annually, to senior management that details the dealer’s supervisory control policies and procedures, summarizes the results of the testing, identifies significant weaknesses, and discusses procedures implemented in response to such testing. Dealers would also be required to establish, maintain, and enforce written supervisory control policies and procedures that provide for the dealer’s: □ Review and monitoring of: (i) all transmittals of funds and securities to and from customer accounts; (ii) changes of customer’s address, including procedures to validate change of address; and (iii) changes in customer investment objectives, including validation of such changes; □ Performance of an independent review of producing managers; and □ Heightened supervision of the activities of each producing manager who is responsible for generating 20% or more of the revenue of the business units supervised by the producing manager’s supervisor. (The rule includes examples of heightened supervisory procedures.) Definitions The rule would also include definitions for the terms OSJ and branch office, which track the definitions in the NASD’s rules. * * * *
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