

Notice to Members

DECEMBER 2004

SUGGESTED ROUTING

Corporate Finance
Executive Representatives
Legal and Compliance
Municipal Securities
Operations
Registered Representatives
Senior Management
Technology
Trading and Market Making
Training

KEY TOPICS

MSRB Rules G-12(f) and G-14
Municipal Securities
Operations
Supervision
Training
Transaction Reporting

GUIDANCE

Municipal Securities

NASD Issues Reminder to Members Regarding the Municipal Securities Rulemaking Board's Implementation of Real-Time Reporting and Dissemination of Transactions in Municipal Securities

Executive Summary

NASD is issuing this *Notice to Members* to remind firms to prepare for the implementation on January 31, 2005, of the reporting of municipal securities transactions within 15 minutes (real-time reporting), immediate dissemination of such transaction information (real-time dissemination), and automated comparison of inter-dealer transactions in such securities. The changes are set forth in amended Municipal Securities Rulemaking Board (MSRB) Rule G-14 and Rule G-12(f). Firms must review *all* areas of their business activities and determine the effect of the amended reporting and comparison rules and real-time dissemination of information on municipal securities transactions. Among other actions, firms should review and revise policies, practices, and procedures, as needed, of associated persons engaged in trading or selling municipal securities, the firm's investment banking operations, the back office, the business line supervisors of any business or operational area that is affected by the changes, and the firm's legal, compliance, and audit departments.

Questions/Further Information

Questions concerning this *Notice* should be directed to Jon Soderlund, Assistant Director, Market Regulation, Regulatory Policy and Oversight (RPO), at (240) 386-5111; Cindy Friedlander, Program Manager, Member Regulation, RPO, at (202) 728-8133; or Sharon K. Zackula, Associate General Counsel, Office of General Counsel, RPO, at (202) 728-8985.

Discussion

On August 31, 2004, the SEC approved a proposed rule change relating to the MSRB's implementation of real-time reporting of transactions in municipal securities, real-time dissemination of such transaction information, automated comparison of inter-dealer trades, and the development of the "Real-Time Transaction Reporting System" (RTRS) facility.¹ As amended, Rule G-14 will require brokers, dealers and municipal securities dealers (collectively, dealers) to report transactions in municipal securities within 15 minutes of the time of trade execution instead of by midnight on trade date, as is currently required. Amended Rule G-12(f) will require dealers to submit inter-dealer transactions for comparison in a central comparison system within the same time frame. The changes to MSRB Rules G-14 and G-12(f) become effective on January 31, 2005. As dealers begin to enter trade information real-time on January 31, 2005, the MSRB will begin real-time dissemination of such transaction data.

The purpose of the rule change is to increase price transparency in the municipal securities market and to enhance the surveillance database and audit trail used by NASD. Accurate and timely automated reporting of municipal securities transaction information is critical to the accurate dissemination of transaction data and resulting price transparency and the effective regulatory oversight of municipal securities trading and sales practices.

The purpose of this *Notice* is to remind firms engaged in municipal securities business of their obligations under MSRB Rules G-14 and G-12(f), as amended. Firms' obligations include the following:

- ▶ Firms must understand the terms of amended MSRB Rules G-14 and G-12(f) and be prepared to report *all* trades in municipal securities within 15 minutes of the time of trade execution, unless the trade is subject to an exception from 15 minute reporting, or there is an exemption from reporting.² Similarly, firms must be prepared to submit inter-dealer transactions in municipal securities to the central comparison system within the same time frame.
- ▶ All firms that engage in a municipal securities business must complete Form RTRS by the deadline set by the MSRB, even if they submit all transaction information through a clearing firm or service bureau, effect no transactions in municipal securities, or only effect transactions in municipal securities that are exempt from reporting (e.g., municipal fund securities, also known as "Section 529 plan" securities). By completing Form RTRS, these firms will confirm with the MSRB how they will be submitting transaction data or that they have no testing or certification requirement.

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- ♦ Firms must comply with all testing and certification requirements by the deadlines established by the MSRB. Certain firms are not required to “test” but all firms must be certified. For example, if all of a firm’s transaction reports are submitted and updated by an agent (a clearing broker or service bureau), the firm will be certified when its agent is certified.³ If a firm’s agent submits some data for a class of trades, but the firm also submits some data (e.g., the firm intends to submit corrections to a trade report previously submitted by the agent to RTRS directly using RTRS Web), then the firm must complete one of the test plans and then be certified.
 - ♦ A firm must make certain that associated persons and their supervisors across the firm have received adequate training to allow the firm to report all transactions in municipal securities timely and accurately upon implementation of amended MSRB Rules G-14 and G-12(f).
 - ♦ A firm must ensure that it has revised its written supervisory policies, practices and procedures to reflect changes both as to the reporting requirements and the availability of additional real-time transaction pricing information prior to implementation of amended MSRB Rules G-14 and G-12(f) and that its supervisory personnel are knowledgeable as to these revisions. Various business areas that may be affected include but are not limited to trading, sales, investment banking, and back office operations. In addition, a firm must ensure that supervisory personnel of affected business areas have implemented such changes.
 - ♦ A firm must enhance communications and back office systems as needed to ensure the firm’s technological and systems readiness as of the date of implementation.
 - ♦ If a firm’s transactions in municipal securities are being reported through a third party, a firm must ensure that the performance of the third party complies with the MSRB’s reporting and related rules, including establishing procedures for the firm to review the performance of the third party and to modify or terminate the relationship if, as a result of the third party’s performance, the firm is not in full compliance with the MSRB’s reporting and related rules.
 - ♦ A firm must assess back office staffing capacity, and reallocate or supplement back office staff if necessary to allow the firm to report municipal securities transactions accurately and timely as of the date of implementation of real-time comparison, reporting, and dissemination of municipal securities transactions.
 - ♦ A firm must review the firm’s legal, compliance, and internal audit policies, practices, and procedures, and amend them as necessary to perform legal, compliance, and audit functions relating to both the amended reporting requirements and the availability of additional real-time transaction pricing information prior to implementation of amended MSRB Rules G-14 and G-12(f).

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- ▶ A firm must review its other supervisory control functions to monitor, test and ensure that, with the changes relating to both the amended reporting requirements and the availability of additional real-time transaction pricing information, the firm is in compliance with the rules of the MSRB.

Many of the obligations referred to above require that firms complete certain actions prior to the implementation of real-time reporting and dissemination, such as executing Form RTRS; testing; obtaining certification; providing adequate training of associated persons and other firm personnel; ensuring the firm's technological and systems readiness; adequately staffing back office operations; and revising policies, practices, and procedures used by business line supervisors and by legal, compliance, audit, and other supervisory control functions. However, it is crucial that firms continue to monitor their compliance with the reporting and dissemination rules and all other MSRB rules on an ongoing basis, and with particular scrutiny during the first months following the implementation of a major regulatory initiative. Upon implementation of real-time reporting and real-time dissemination, firms must monitor their compliance performance to determine if the firms' actions and plans prior to implementation have resulted in full compliance with the rule changes. If needed, firms must take additional steps in areas where compliance has not been achieved to address the issues identified. In addition, with substantial changes in reporting processes and procedures, the introduction of real-time dissemination, and the new availability of real-time pricing information, firms should review diligently affected business areas, and related amended policies, practices, and procedures, to ensure that the changes made in one area do not result in unintended consequences that create separate regulatory deficiencies or issues in another area.

NASD will continue to review firms engaged in municipal securities business to ensure that, with respect to the new reporting requirements and the availability of real-time transaction pricing information, firms have adopted comprehensive policies, practices and procedures to ensure full compliance with amended MSRB Rules G-14 and G-12(f), and to ensure that current pricing information that is publicly available or otherwise available to the firm is considered appropriately in pricing municipal securities. In addition, NASD will review firms to determine if firms have amended their written supervisory policies, practices, and procedures to reflect the changes effected in various business areas (e.g., trading or selling municipal securities, the firms' investment banking operations, the back office) and have implemented such changes. Finally, NASD will review firms to determine if firms have reviewed and updated policies, practices, and procedures in firms' legal, compliance, and audit departments, and other supervisory control functions to monitor, test, and ensure that firms are in compliance with the rules of the MSRB.

Endnotes

- 1 Securities Exchange Act Release No. 50294 (August 31, 2004), 69 FR 54170 (September 3, 2004) (SR-MSRB-2004-02) (SEC approval order).
- 2 In certain situations, dealers will be allowed to report transactions in longer timeframes. See MSRB Rule G-14(a)(ii), as amended. In addition, certain transactions in municipal securities are exempt from reporting. These include transactions in municipal securities that are ineligible for CUSIP number assignment, municipal fund securities transactions, and inter-dealer transactions that are not eligible for comparison. See MSRB Rule G-14(b)(vi), as amended.
- 3 "Real-Time Transaction Reporting: Revised RTRS Certification Test Plan (July 28, 2004)," at www.msrb.org/msrb1/whatsnew/RevCertificationestplan.htm.

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