



DEALER RESOURCE

Compliance Advisory for Brokers, Dealers and Municipal Securities Dealers

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Introduction

The Municipal Securities Rulemaking Board (MSRB) is providing this Compliance Advisory to assist brokers, dealers and municipal securities dealers (collectively “dealers”) in proactively addressing compliance risks.¹ The absence of adequate supervisory controls to comply with MSRB rules could adversely affect investors, municipal entities, obligated persons and public confidence in the municipal securities market.

The MSRB intends for dealers to use this advisory as a tool to supplement their assessment of the adequacy of their compliance programs. To that end, the advisory highlights aspects of several MSRB rules and provides examples of factors a dealer may, depending on its particular business model, consider when evaluating the effectiveness of its existing compliance controls and the need to implement measures to mitigate exposure to potential compliance risks (identified as “Considerations”).²

¹ The MSRB also identifies key compliance risks to assist the Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) in the development of their regulatory examination programs for dealers consistent with Section 15B(b)(4) of the Securities Exchange Act of 1934 (Exchange Act).

² This advisory is not legal advice and is not intended to address all regulatory obligations applicable to dealers pursuant to MSRB rules or other federal securities laws or create a safe harbor with respect to potential deficiencies in a dealer’s compliance processes, controls or supervisory system.

Compliance Risk Areas

Professional Qualification Standards (MSRB Rules G-2, G-3 and A-12)

MSRB Rules G-2 and G-3 establish standards of professional qualification. Pursuant to Rule G-2, no dealer shall effect any transaction in, or induce or attempt to induce the purchase or sale of, any municipal security without being qualified in accordance with MSRB rules. More specifically, a dealer is required to register with the MSRB pursuant to Rule A-12, and the associated persons of a dealer are required to be qualified to engage in municipal securities activities pursuant to Rule G-3.

In addition, Rule G-2 prohibits a firm from engaging in municipal advisory activities without being registered with the MSRB as a municipal advisor, which first necessitates municipal advisor registration with the SEC.³ If a dealer avails itself of an exemption or exclusion provided under the SEC's Final Municipal Advisor Registration Rule that specifically permits the dealer to engage in certain municipal advisory activities without registration as a municipal advisor, the dealer would not be required to register as a municipal advisor under Rule A-12.



CONSIDERATIONS:

- How does the firm ensure that each of its associated persons, including principals, involved in municipal securities activities only engage in the specific activities that are permitted by their qualification (e.g., an associated person with the Municipal Securities Sales Principal qualification (Series 9/10) is not engaged in approving municipal securities-related advertising).
- Whether the firm has provided appropriate training to its associated persons to ensure that they understand the scope of municipal advisory activities and do not engage in activities that are outside the scope of an exemption or exclusion from registration, unless properly qualified (e.g., understanding the source of funds in a municipal entity client's account to appreciate whether the associated person is providing advice to a municipal entity on the investment of bond proceeds).
- If the firm is availing itself of the underwriter exclusion, the time frame of which "generally begins upon the municipal issuer's engagement of the underwriter for a particular issuance of municipal securities and ends at the end of the underwriting period for that issuance,"⁴ what procedures has the firm developed to ensure it is adhering to the limited time frame when municipal advisor registration is not required.

³ See Exchange Act Release No. 70462 (September 20, 2013), 78 FR 67467 (November 12, 2013) ("SEC's Final Municipal Advisor Registration Rule").

⁴ See SEC's Final Municipal Advisor Registration Rule, 78 FR at 67490, n.296.



CONSIDERATIONS: *(continued)*

- If the firm is relying on the independent registered municipal advisor (IRMA) exemption, does the firm have a process to ensure that such reliance is reasonable and that the IRMA is providing advice with respect to the same aspects of a municipal financial product or issuance of municipal securities.
- Whether, with respect to the IRMA exemption, the firm has a process to provide the written notice to the municipal entity or obligated person, as well as to that entity's IRMA, disclosing that the dealer is not a municipal advisor and, with respect to the municipal entity, is not subject to the statutory fiduciary duty.

Best Execution and Fair Pricing Standards (MSRB Rules G-18 and G-30)

MSRB Rule G-18, on best execution, requires a dealer to use reasonable diligence to ascertain the best market for a subject security and buy or sell in that market so that the resulting price to the customer is as favorable as possible under the prevailing market conditions. Failure to have obtained the most favorable price possible will not necessarily mean that the dealer failed to use reasonable diligence. A dealer must have sound policies and procedures reasonably designed to achieve best execution.

Rule G-30, on prices and commissions, requires a dealer to purchase from and sell to customers at an aggregate price (including mark-up or mark-down) that is fair and reasonable. A fair and reasonable price must bear a reasonable relationship to the prevailing market price of the security. A dealer must exercise reasonable diligence in establishing the market value of the security and the reasonableness of the compensation received on the transaction.



CONSIDERATIONS:

- Whether the firm's policies and procedures reflect that the term "market" is to be construed broadly and, unless the context requires otherwise, the term encompasses a variety of different venues, including broker's brokers, alternative trading systems or platforms, or other counterparties, which may include the dealer itself as principal.
- Whether the firm's policies and procedures include how and when its trading desk exposes retail customer orders to multiple offerings or bids, and shows external offerings and bids to retail customers (directly or through its financial advisors).
- Whether the firm periodically evaluates the factors it uses to determine whether the aggregate price to a customer is fair and reasonable and that such price bears a reasonable relationship to the prevailing market price of the security.
- Whether the firm periodically evaluates the factors it uses to determine the fairness and reasonableness of a commission or service charge.



CONSIDERATIONS: (continued)

- Whether the firm employs automated tools that allow the dealer to limit its trading, with, for example, specific parties or parties with specified attributes with which it does not want to interact, and, if so, whether the firm periodically reviews its use of such tools to ensure such use serves a legitimate purpose.
- Whether the firm has a process to periodically, but at least annually, review the reasonableness of its policies and procedures for best execution to evaluate the quality of the executions the dealer is obtaining under its current policies and procedures and other factors such as changes in market structure, new entrants, the availability of additional pre-trade and post-trade data, and the availability of new technologies.
- Whether the firm's procedures address the best-execution determinations it makes with respect to securities with limited quotations or other pricing information, and whether the firm has implemented policies and procedures that address other potential market conditions or variables.
- If the firm routes its customers' transactions to another dealer that has agreed to handle those transactions as agent or riskless principal for the customer (e.g., a clearing firm or other executing dealer), whether the firm has a process to periodically review how the other dealer conducts its periodic review of best execution and the results of that review.

Standards of Conduct in the Performance of Financial Advisory Activities (MSRB Rule G-23)

MSRB Rule G-23 generally prohibits a dealer that is acting as a financial advisor on an issuance of municipal securities from underwriting that issuance. A dealer will not be viewed as a financial advisor for purposes of Rule G-23 if the dealer, at the earliest stages of its relationship with the issuer, clearly identifies itself in writing as an underwriter and in its capacity as underwriter provides advice to an issuer on matters integrally related to the issue being underwritten, including advice on the structure, timing and terms of the issue. A dealer should be mindful that the statutory definition of "municipal advisor" is very broad and the provision of advice that would not prohibit the dealer under Rule G-23 from being an underwriter could, absent the dealer availing itself of an exemption or exclusion, cause the dealer to assume a fiduciary duty and necessitate registration as a municipal advisor.⁵

Pursuant to Rule G-23(c), a dealer acting as a financial advisor has an obligation to evidence the advisory relationship in writing prior to, upon or promptly after the dealer has commenced the advisory relationship with the provision of consultant or financial advisory services. However, in the absence of the requisite writing, a financial advisory relationship will be deemed to exist if the dealer renders financial advisory or consultant services to or on behalf of an issuer with respect to the issuance of securities, including advice on the structure, timing, terms and other similar matters regarding such issue.

⁵ See SEC's Final Municipal Advisor Registration Rule. See also Guidance on the Prohibition on Underwriting Issues of Municipal Securities for Which a Financial Advisory Relationship Exists Under Rule G-23 (MSRB Notice 2011-66) (November 27, 2011).



CONSIDERATIONS:

- Whether the firm has procedures to ensure that, at the earliest stage, it provides issuers written notification of the firm's role as a consultant or financial advisor or, in the alternative, the firm clearly specifies its intention to engage in an arm's-length transaction.
- Recognizing that the provision of financial advisory services may cause the firm to be considered a "municipal advisor" under the Exchange Act and the rules promulgated thereunder,⁶ does the firm have controls to ensure that it does not engage in activity requiring it to register as a municipal advisor unless it is so registered or exempt from registration.
- Whether the firm has a process to review any existing financial advisory relationships to ensure ongoing compliance with the Rule G-23.

Fair Dealing with All Persons in the Conduct of Municipal Securities Activity (MSRB Rule G-17)

MSRB Rule G-17 requires a dealer, in the conduct of its municipal securities activities, to deal fairly with all persons and prohibits it from engaging in any deceptive, dishonest, or unfair practice. This duty exists in the absence of fraud and applies equally to a dealer's interactions with investors and other market participants, including issuers of municipal securities and regulators.

The duty under Rule G-17 requires a dealer acting as the underwriter in a negotiated underwriting to make specific disclosures to the issuer to clarify the dealer's role in the issuance and to disclose any actual or potential material conflicts of interest with respect to the issuance.⁷ In responding to an issuer's request for proposals or qualifications, a dealer must fairly and accurately describe its capacity, resources and knowledge to perform the proposed underwriting as of the time the proposal is submitted. An underwriter must also have a reasonable basis for the representations and other material information contained in documents it prepares (e.g., an issue price certificate), and must refrain from including representations or other information it knows or should know are inaccurate or misleading.

⁶ Pursuant to Section 15B(e)(4)(A)(i) and (ii) of the Securities Exchange Act of 1934 (Exchange Act), municipal advisory activities include (i) advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or (ii) the undertaking of a solicitation of a municipal entity.

⁷ See Interpretive Notice on the Duties of Underwriters to State and Local Government Issuers (MSRB Notice 2012-25) (May 7, 2012) and MSRB Answers Frequently Asked Questions (FAQs) Regarding an Underwriter's Disclosure Obligations to State and Local Government Issuers Under Rule G-17 (MSRB Notice 2013-08) (March 25, 2013).



CONSIDERATIONS:

- Whether the firm has a process to ensure that its associated persons understand and adhere to the fundamental duty of fair dealing owed to all persons in the conduct of municipal securities activities.
- Whether the firm has procedures to evaluate whether a customer account through which municipal securities transactions are effected is the appropriate account structure for the customer based on the customer's intent and other factors (e.g., an account for a customer that has a fee structure that reasonably can be expected to result in a greater cost to the customer versus an alternative account offered by the dealer that provides the same services and benefits to the customer, but will be less costly for the customer).
- Whether the firm has a process to ensure that representations made by the underwriter to the issuer, whether written or oral, are truthful and accurate and do not misrepresent or omit material facts.
- Whether the firm has a process to ensure that disclosures are updated as needed to remain accurate during the underwriting engagement, such as disclosure of a conflict that is discovered or arises after an underwriter has been engaged.
- Whether the firm has controls that are reasonably designed to ensure that requisite disclosures are made on a timely basis, such as disclosure of the underwriter's compensation when the underwriter is engaged to perform services rather than, for example, providing such disclosures solely in a bond purchase agreement.
- If utilizing a template for underwriter disclosures, whether the firm undertakes reasonable diligence to determine that the disclosures made to issuers are sufficiently robust to adequately make clear, among other things, its compensation, role, capacity and resources to perform the services, and any actual or potential material conflicts of interest. In addition, whether the firm has a process to ensure that disclosures are made in a fair and balanced manner so that the implications of such disclosures are clear to the issuer.
- Whether the firm has controls to ensure bid-wanted or offerings are not placed with a broker's broker only for price discovery purposes, as using a broker's broker in that manner harms the bid-wanted and offering process by reducing bidders, thereby reducing the likelihood that the high bid in a bid-wanted will represent the fair market value of the securities.
- If the firm has agreed to underwrite a transaction with a retail order period, whether the firm has a process to ensure that the securities are allocated in a manner that honors the issuer's priority requirements, including controls to prevent the dealer from knowingly accepting an order that is inconsistent with the issuer's expectations regarding retail orders, such as an order framed as an order for a retail customer when it is not.

Pay-to-Play Restrictions (MSRB Rule G-37)

MSRB Rule G-37, on political contributions and prohibitions on municipal securities business, prohibits a dealer, as well as its municipal finance professionals (MFPs), from engaging in municipal securities business, subject to certain exceptions, for two years after a triggering contribution has been made to an official of a municipal entity by the dealer, MFP or a political action committee controlled by either the dealer or MFP. The rule also prohibits dealers and MFPs from doing indirectly what the rule prohibits them from doing directly, and includes tailored prohibitions on soliciting and coordinating contributions or payments to certain officials of a municipal entity or certain political parties of states and localities, respectively. The two-year ban on business would not apply to a contribution made by an MFP who is entitled to vote for the official of the municipal entity and total contributions made to the official by such MFP do not exceed \$250 per election.

Each dealer must report information regarding certain contributions to the MSRB on a quarterly basis; by the last day of the month following the end of each calendar quarter (*i.e.*, January 31, April 30, July 31 and October 31).



CONSIDERATIONS:

- Whether the firm has provided appropriate training to the applicable associated persons to ensure they understand that all contributions — not just a deposit of money, but anything of value, such as a gift or hosting a reception — need to be reported to the firm so it is able to make timely and accurate quarterly reports.
- Whether the firm has a process to monitor two-year look back periods to ensure that a triggering contribution, if any, has been accounted for and the firm complies with the resulting ban.
- If the dealer is also a municipal advisor, the firm needs to be mindful that the scope of the ban under Rule G-37 will depend on the type of influence that can be exercised by the official to whom the political contribution is made and not the particular line of business with which the contributor (MFP or municipal advisor professional) may be associated.
- Does the firm have procedures to ensure that quarterly reports are being made timely, completely and accurately, providing the MSRB, for example, details on contributions to bond ballot campaigns, officials of a municipal entity or political parties and the contribution amount (which, in the case of in-kind contributions, must include both the value and the nature of the goods or services provided).
- If the dealer is also a municipal advisor, whether the firm has a process to ensure that it is completing all relevant portions of Form G-37 (*e.g.*, if activity falls within the definition of both municipal securities business and municipal advisory business, such activity should be disclosed under both fields).

Time of Trade Disclosures to Customers (MSRB Rule G-47)

MSRB Rule G-47, on time of trade disclosures, requires a dealer to disclose all material information about a transaction as well as material information about a security to a customer, at or prior to the time of trade. This disclosure requirement applies regardless of whether the transaction is solicited or unsolicited, occurs in a primary offering or the secondary market, or is a principal or agency transaction. Information is material if there is a substantial likelihood that the information would be considered important or significant by a reasonable investor in making an investment decision. Such material information includes information known by the dealer, and information that is reasonably accessible to the market (*i.e.*, information that is publicly available through established industry sources, such as the Electronic Municipal Market Access (EMMA[®]) website and rating agency reports). These disclosures can be made orally or in writing to a customer, but the disclosures required under Rule G-47 do not apply if the dealer has reasonably concluded, consistent with MSRB Rule G-48, that the customer is a sophisticated municipal market professional (SMMP), as defined in MSRB Rule D-15.



CONSIDERATIONS:

- Whether the firm has a process to evaluate whether it is utilizing established industry sources of information relating to municipal securities transactions, recognizing that new sources could become available and become generally used by dealers that effect transactions in the type of municipal securities at issue.
- Does the firm have a supervisory control to ensure that the customer was, either orally or in writing, provided the material information known by the dealer about the transaction.
- Does the firm have a supervisory control to obtain and document affirmations from its SMMP customers, whether such affirmations are provided on a trade-by-trade basis, a type-of-transaction basis, a type-of-municipal-security basis or an account-wide basis.
- Recognizing that Rule G-47 provides a non-exhaustive list, whether the firm has a process for identifying which information regarding a municipal security is material and, therefore, is required to be disclosed to a customer at the time of trade (*e.g.*, a market discount because it may have tax implications).
- Whether the firm has a procedure to ensure that material information regarding municipal securities is disseminated to registered representatives who are engaged in sales to and purchases from a customer.

Supervisory Controls (MSRB Rule G-27) and Books and Records (MSRB Rules G-8 and G-9)

MSRB Rule G-27, on supervision, requires a dealer to supervise the municipal securities activities of the dealer and its associated persons. A dealer is required to adopt, maintain and enforce written supervisory procedures reasonably designed to ensure that the conduct of the dealer and its associated persons is following applicable securities laws and regulations and MSRB rules. Such procedures shall codify the dealer's supervisory system for ensuring compliance and, at a minimum, include provisions on how a designated principal supervises the municipal securities activities of associated persons and procedures for the maintenance and preservation of the books and records required to be maintained and preserved under MSRB Rules G-8 and G-9.

Rule G-8 generally sets forth the recordkeeping requirements for dealers, such as the requirement to make and keep certain records applicable to its business, including account records, securities records, customer complaint records and records concerning compliance with its supervisory obligations. Rule G-9(h) establishes standards for the preservation of records by a dealer and generally requires that books and records be preserved in such manner as to be readily accessible for a period of at least two years.



CONSIDERATIONS:

- Whether the firm maintains written supervisory procedures (WSPs) that sufficiently describe the supervisory process, including identifying one or more principal(s) responsible for carrying out the supervisory responsibilities identified.
- Whether the firm has a process for monitoring regulatory developments, including applicable rule changes, to ensure that the written supervisory procedures remain reasonably designed to achieve compliance and that changes in rules and regulations from other regulatory frameworks do not get inappropriately applied for purposes of compliance with MSRB rules (e.g., WSPs reflect that in complying with the underwriter obligations under Rule G-32, the firm observes the definition of "underwriter" provided in Rule G-32 or when a term used in an MSRB rule is not specifically defined, the term has the respective meaning set forth in the Exchange Act).
- Whether the firm has supervisory controls to ensure that neither the firm nor its associated persons engage in activities that trigger additional registration requirements and that, prior to engaging in such activities, the firm will satisfy the applicable professional qualification requirements, adhere to the applicable standards of conduct and establish reasonably designed procedures to supervise the activities.
- If the firm does engage in municipal advisory activities and, in lieu of registering as a municipal advisor, relies on an exemption or exclusion from registration, whether the firm has a process to document that reliance and ensure the it adheres to the limitations of such exclusion or exemption.



CONSIDERATIONS: (continued)

- Whether the firm, as a means of securities control, maintains a securities record that shows, for each municipal security position carried by the firm for its own account or for the account of a customer, whether the account is long or short and the offsetting position to all such securities short, and the name or other designation of the account in which each long, short or offsetting position is carried.
- Whether the firm has supervisory controls to ensure that information required to be reported to the MSRB is reported accurately (e.g., information provided pursuant to Rule G-32 must be accurate whether the firm enters the information into Form G-32 directly or via the New Issue Information Dissemination Service).
- Whether the firm has a reasonable process to assess whether the private placement of municipal debt is a municipal security to determine the applicability of MSRB rules,⁸ or whether acting as a placement agent in the issuance of non-municipal securities results in the dealer engaging in solicitation activity that, based on the facts and circumstances, triggers the requirement to register as a municipal advisor.⁹
- If a dealer relies on an outside service provider to perform certain functions or activities, what due diligence measures does the firm undertake to ensure the outsourcing arrangement does not impede the firm's supervisory controls.
- Whether the firm has implemented reasonable safeguards and technical controls to protect its data and technology systems from cyber threats.

⁸ See Financial Advisors, Private Placements, and Bank Loans (MSRB Notice 2011-37) (August 3, 2011) and Potential Applicability of MSRB Rules to Certain Direct Purchasers and Bank Loans (MSRB Notice 2011-52) (September 12, 2011).

⁹ See SEC's Final Municipal Advisor Registration Rule, 78 FR at 67515, n.628.

Conclusion

Regulatory guidance is essential to supporting market participants who are committed to maintaining a fair and efficient municipal market. The MSRB is committed to continuing to develop resources that promote regulated entities' compliance with new and existing standards of conduct. This advisory is designed to aid dealers in the development of effective policies and procedures for supervision and compliance and the assessment of their compliance programs. The MSRB engages in an ongoing dialogue with municipal market participants through outreach events and education activities. Dealers are encouraged to visit the MSRB's website (www.msrb.org) to review other informational material regarding MSRB rules, including on-demand webinars, interpretive guidance and additional compliance resources.¹⁰

This guide for municipal securities dealers is intended for general information purposes only. Information in this guide is provided without warranties, express or implied. The MSRB shall have no liability to any recipient, including for any inaccuracies, errors or omissions or other defects in the information or any damages resulting therefrom. The information contained herein is not intended to provide legal advice and does not guarantee compliance with regulatory requirements or create a safe harbor from regulatory responsibilities or liabilities.

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¹⁰ Dealers can also subscribe to MSRB email updates on the MSRB's website to ensure they receive information from the MSRB on upcoming events, educational resources and news in a convenient electronic format.