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March 5, 2019

**Category**

Fair Practice

**Affected Rules**

[Rule G-11](#), [Rule G-17](#),  
[Rule G-25](#)

## Request for Comment on Draft Interpretive Guidance on Application of MSRB Rules to Certain Prearranged Trading in Connection with Primary Offerings

### Overview

The Municipal Securities Rulemaking Board (MSRB) is requesting comment on draft interpretive guidance (the “draft guidance”) concerning the application of MSRB rules and prior interpretive guidance to certain prearranged trading in connection with primary offerings of municipal securities. The MSRB invites all interested parties to submit comments in response to this request, along with any other information they believe would be useful in developing the draft guidance.

Comments should be submitted no later than March 5, 2019, and may be submitted in electronic or paper form. [Comments may be submitted electronically by clicking here](#). Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1300 I Street NW, Suite 1000, Washington, DC 20005. All comments will be available for public inspection on the MSRB's website.<sup>1</sup>

Questions about this notice should be directed to John Bagley, Chief Market Structure Officer, or Lanny Schwartz, Chief Regulatory Officer, at 202-838-1500.

### Background and Regulatory Justification

MSRB Rule G-11, on primary offering practices, requires brokers, dealers and municipal securities dealers (collectively, “dealers”) that are

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



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participating in a syndicate for the purchase and distribution of a new issue of municipal securities to establish priority provisions to govern the allocation and orderly distribution of the bonds. Unless otherwise agreed to with the issuer, these priority provisions must give priority to customer orders over orders by members of the syndicate for their own accounts or orders for their respective related accounts (*e.g.*, retail order periods). Additionally, Rule G-11(b) requires every dealer that submits an order to a syndicate or to a member of the syndicate for the purchase of municipal securities held by the syndicate to disclose at the time of submission of such order whether the securities are being purchased for its own account or for a related account.

MSRB Rule G-17, on conduct of municipal securities and municipal advisory activities, requires dealers to deal fairly and to not engage in any deceptive, dishonest or unfair practice. This requirement extends to dealings with all persons, including other dealers, investors and issuers. In 2012, the MSRB issued an interpretive notice (the “2012 Guidance”) that clarified the nature and scope of a dealer’s fair-dealing obligations to issuers in connection with the underwriting of their municipal securities by providing guidance on and prescribing requirements related to a number of issues, including retail order periods.<sup>2</sup>

MSRB Rule G-25, on improper use of assets, prohibits dealers from guaranteeing or offering to guarantee customers against loss in transactions in municipal securities with or for customers, as well as from sharing, directly or indirectly, in the profits or losses of a transaction in municipal securities with or for a customer.

In connection with primary offerings in the municipal securities market, the type of prearranged trading that is the primary focus of this request for comment and the draft guidance typically occurs when, prior to the completion of the distribution of a new issue, a dealer that is not a member of the underwriting syndicate or selling group (a “non-syndicate/selling group dealer”) arranges to purchase bonds that are the subject of the distribution from a syndicate/selling group member or an investor at or above the list offering price, typically once the bonds are free to trade.<sup>3</sup> The

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<sup>2</sup> See [MSRB Notice 2012-25](#) (May 7, 2012); see also Securities Exchange Act of 1934 (“Exchange Act”) Rel. No. 66927 (May 4, 2012), 77 FR 27509 (May 10, 2012) (SR-MSRB-2011-09).

<sup>3</sup> Recent enforcement actions by the U.S. Securities and Exchange Commission (SEC) highlight these and other types of prearranged trading in connection with primary offerings

non-syndicate/selling group dealer enters into the prearranged trade to increase the likelihood that it can purchase the bonds for its own account because an order for an investor, for example, would, in the offering in question, receive a higher priority allocation than an order placed directly by the non-syndicate/selling group dealer for its own account as determined by the issuer's and syndicate's requirements.<sup>4</sup> In this example, the explicit or implicit assumption of the parties is that, when the order is placed by the syndicate/selling group member or investor, the non-syndicate/selling group dealer's interest in the order will not be properly disclosed.

In this type of prearranged trading, the non-syndicate/selling group dealer effectively is using the syndicate/selling group member or the investor to accomplish secretly, and indirectly, what the non-syndicate/selling group dealer likely could not do directly. By making it appear to the senior syndicate manager of the new issue that the order is for an account that would receive a higher priority than an order of a non-syndicate/selling group dealer for its own account or that the investor was purchasing bonds for its own account in accordance with the applicable syndicate restrictions, the non-syndicate/selling group dealer is using the syndicate/selling group member or the investor as a proxy. In this case, the non-syndicate/selling group dealer might not have received bonds if it had placed an order directly with the syndicate for its own account.

The MSRB believes this type of prearranged trading in connection with a primary offering may have a negative impact on the fairness and efficiency of the municipal securities market. Specifically, this practice could cause senior syndicate managers, who often are in communication with issuers regarding allocations, to fill orders from members of the syndicate or selling group that they might not have filled had they known that they effectively were orders for non-syndicate/selling group dealers. Correspondingly, this practice also could cause customer orders that meet the priority provisions to receive a

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that constitute violations of MSRB rules. See, e.g., <https://www.sec.gov/news/press-release/2018-153> (announcing charges against certain entities and individuals engaged in "flipping," in which they posed as retail investors to purchase new issue municipal bonds based on a prearranged understanding that the bonds would be sold immediately to dealers for a fee, and settling administrative proceedings against a dealer and present and former associated persons of that firm for related misconduct).

<sup>4</sup> As discussed in the draft guidance, an order of the syndicate/selling group member either for its own account or represented as an order for a customer also would have a higher priority than a non-syndicate/selling group dealer's order for its own account. The non-syndicate/selling group dealer may be willing to compensate the syndicate/selling group member or the investor for the benefit of the higher priority allocation because it believes it will be able to sell the bonds at a higher price in the secondary market.

lower allocation of a new issue than they should have because the bonds ultimately purchased by the non-syndicate/selling group dealer through a prearranged trade received a higher priority than they otherwise would have if the non-syndicate/selling group dealer placed an order to purchase them for its own account directly.

As a further consequence, the MSRB understands that the non-syndicate/selling group dealer often sells the bonds purchased in a prearranged trade to retail investors after the distribution in the secondary market at prices above the list offering price, thereby causing some investors to pay more for the bonds than they otherwise would have if they had been able to purchase them at the list offering price as part of the initial distribution.

Finally, the prices at which prearranged trades are executed could be substantially away from the true prevailing market price of the bonds when they are free to trade, potentially causing the dissemination of artificial and misleading pricing information to other market participants, which could reduce the efficiency of the secondary market.

The draft guidance is intended to remind dealers of existing MSRB requirements, and to illustrate how MSRB rules and the 2012 Guidance apply to the various dealers involved in the sequence of events that culminates in a prearranged trade. Specifically, the draft guidance serves as a reminder that a non-syndicate/selling group dealer that purchases bonds in a prearranged trade is engaging in a deceptive, dishonest and/or unfair practice that constitutes a violation of Rule G-17. The draft guidance also reminds that, depending on the facts and circumstances, a syndicate or selling group member, either as the seller in a prearranged trade or otherwise involved in the distribution of the bonds that fulfill the prearranged trade could violate Rule G-11 and Rule G-17.

Importantly, the draft guidance is not intended to preclude dealers outside of a syndicate or selling group from entering orders with syndicate/selling group members and purchasing bonds for their own accounts in accordance with priority provisions established by the syndicate, or to limit communications between dealers and investors regarding new issues, which are not for the purpose of evading applicable MSRB rules. Finally, the draft guidance is not intended to preclude dealers or investors from purchasing bonds in a new issue, without the use of a prearranged trade, and then selling them in the secondary market shortly thereafter, or to otherwise discourage ordinary secondary market trading.

## Request for Comment

The MSRB seeks public comment on the draft guidance and the following questions, as well as on any other relevant topic. The MSRB particularly welcomes statistical, empirical and other data from commenters that may support their views and/or support or refute the views, assumptions or issues raised in this request for comment and the draft guidance.

- 1) How common is the type of prearranged trading in connection with primary offerings as described in the draft guidance? Are there other variations of prearranged trading that are prevalent and should be addressed specifically in the draft guidance?
- 2) Are there reasons for a non-syndicate/selling group dealer to engage in prearranged trading in connection with primary offerings, as described in the draft guidance, other than purchasing bonds for its account that it otherwise might not be able to purchase due to the priority of orders?
- 3) Do the interpretations in the draft guidance capture any secondary market trading that commenters believe is not violative of Rule G-17 and/or the other noted MSRB rules? If so, please explain how.
- 4) Would the draft guidance, if issued, create direct, indirect, or inadvertent costs or burdens? If so, what are the estimates of those costs and is there data or other evidence, including studies or research, that support commenters' cost or burden estimates?

January 3, 2019

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## Text of Draft Guidance

### **Interpretive Guidance on the Application of MSRB Rules to Certain Prearranged Trading in Connection with Primary Offerings**

This guidance is intended to remind dealers of existing MSRB requirements under MSRB Rule G-11, on primary offering practices, and MSRB Rule G-17, on conduct of municipal securities and municipal advisory activities, and to

illustrate the applicability of those and other MSRB rules, as well as principles contained in prior guidance, to brokers, dealers and municipal securities dealers (collectively, “dealers”) that engage in certain prearranged trading in connection with primary offerings, as described below.

## Background

### Priority Provisions

Rule G-11(e)(i) provides for an underwriting syndicate to establish priority provisions.

Unless otherwise agreed to with the issuer, such priority provisions shall give priority to customer orders over orders by members of the syndicate for their own accounts or orders for their respective related accounts, to the extent feasible and consistent with the orderly distribution of securities in the offering. Notwithstanding the preceding sentence, a syndicate may include a provision permitting the syndicate manager or managers on a case-by-case basis to allocate securities in a manner other than in accordance with the priority provisions, if the syndicate manager or managers determine in its or their discretion that it is in the best interests of the syndicate. In the event any such allocation is made, the syndicate manager or managers shall have the burden of justifying that such allocation was in the best interests of the syndicate.<sup>1</sup>

These priority provisions can include, but are not limited to, retail order periods.

Rule G-11(f), among other things, requires that, prior to the first offer of any securities by a syndicate, the senior syndicate manager provide any syndicate/selling group members information related to requirements of the issuer, including, but not limited to, the priority provisions.

Further, Rule G-11(k) requires any dealer that submits an order during a retail order period to the senior syndicate manager, which could include syndicate/selling group members and non-syndicate/selling group dealers, to provide the following information to assist in the determination that such order is a bona fide retail order:

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<sup>1</sup> Rule G-11(e)(i); see also [Interpretation on Priority of Orders for Securities in a Primary Offering Under Rule G-17](#) (Oct. 12, 2010).

- (i) whether the order is from a customer that meets the issuer's eligibility criteria for participation in the retail order period;
- (ii) whether the order is one for which a customer is already conditionally committed;
- (iii) whether the broker, dealer, or municipal securities dealer has received more than one order from such retail customer for a security for which the same CUSIP number has been assigned;
- (iv) any identifying information required by the issuer, or the senior syndicate manager on the issuer's behalf, in connection with such retail order (but not including customer names or social security numbers); and
- (v) the par amount of the order.

The senior syndicate manager may rely on the information furnished by each dealer that provided the information required unless the senior syndicate manager knows, or has reason to know, that the information is not true, accurate or complete.<sup>2</sup>

Additionally, Rule G-11(b) requires that every dealer that submits an order to a syndicate or to a member of the syndicate for the purchase of municipal securities held by the syndicate disclose at the time of submission of such order if the securities are being purchased for its own account or for a related account.

#### Fair-Dealing Obligations

Rule G-17 requires dealers, in the conduct of their municipal securities activities, to deal fairly with all persons and to not engage in any deceptive, dishonest or unfair practice. This requirement extends to dealings with all persons, including other dealers, investors and issuers.<sup>3</sup> In 2012, the MSRB adopted an interpretive notice that clarified the nature and scope of a dealer's fair-dealing obligations to issuers in connection with the underwriting of their municipal securities by providing guidance on and

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<sup>2</sup> See Rule G-11(k).

<sup>3</sup> See [Reminder Notice on Fair Practice Duties to Issuers of Municipal Securities](#), MSRB Notice 2009-54 (Sept. 29, 2009); [Rule G-17 Interpretive Letter – Purchase of new issue from issuer](#) (Dec. 1, 1997).

prescribing requirements related to a number of issues, which included retail order periods (“2012 Guidance”).<sup>4</sup>

As part of the 2012 Guidance, the MSRB described how underwriters (*i.e.*, sole underwriters or syndicate members) can violate Rule G-17 when engaging in conduct that is inconsistent with retail order periods established by the syndicate on behalf of the issuer in an underwriting. Specifically, the 2012 Guidance established the following:

- Rule G-17 requires an underwriter that has agreed to underwrite a transaction with a retail order period to, in fact, honor such agreement;
- A dealer that wishes to allocate securities in a manner that is inconsistent with an issuer’s requirements must not do so without the issuer’s consent;
- Rule G-17 requires an underwriter that has agreed to underwrite a transaction with a retail order period to take reasonable measures to ensure that retail clients are bona fide;
- An underwriter that knowingly accepts an order that has been framed as a retail order when it is not would violate Rule G-17 if its actions are inconsistent with the issuer’s expectations regarding retail orders; and
- A dealer that places an order that is framed as a qualifying retail order, but in fact represents an order that does not meet the qualification requirements to be treated as a retail order violates its Rule G-17 duty of fair dealing.

Although the 2012 Guidance focused on retail order periods, Rule G-11, as noted above, requires underwriters (unless by agreement with the issuer otherwise) to give priority to all customer orders, not just retail customer orders, over orders by members of the syndicate for their own accounts or orders for their respective related accounts, and the principles of fair-dealing are equally applicable to other priority provisions, including any allocation priority accorded to institutional investors. Thus, underwriters are required to honor their agreements with issuers and must not allocate securities in a

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<sup>4</sup> See [MSRB Notice 2012-25](#) (May 7, 2012); see also Securities Exchange Act of 1934 (“Exchange Act”) Rel. No. 66927 (May 4, 2012), 77 FR 27509 (May 10, 2012) (SR-MSRB-2011-09). The 2012 Guidance does not apply to selling group members. *Id.*



manner that is inconsistent with any of the priority provisions, retail or otherwise, without the issuer's consent.

Additionally, although the 2012 Guidance does not apply to selling group members, as noted above, the MSRB has previously stated that all activities of dealers must be viewed in light of the basic fair-dealing principles of Rule G-17, regardless of whether other MSRB rules establish additional requirements on dealers.<sup>5</sup> In this case, as fully described above, Rule G-11 establishes requirements that effectively govern the conduct of selling group members in the same way that the 2012 Guidance governs the conduct of underwriters in regard to priority provisions and the allocation of securities. Specifically, sections (b), (f) and (k) of Rule G-11 collectively require that every dealer disclose the capacity in which they submit an order to an underwriter, and to make certain representations and disclosures when submitting an order during a retail order period, and that senior syndicate managers provide selling group members with information regarding issuer requirements, including priority provisions. Accordingly, any false or misleading representation made by a selling group member that knows the priority provisions, but frames an order to an underwriter as qualifying as an order type that it is not, and might cause the underwriter to allocate securities in a manner that is inconsistent with the issuer's requirements and expectations, would constitute violations of both Rule G-11 and Rule G-17.

#### Profit-Sharing with Investors and Guarantees Against Loss

In addition to establishing the above duties regarding the priority of orders in a primary offering, the 2012 Guidance identified other potential violations of Rule G-17 and other MSRB rules that could be applicable to the prearranged trading described in this guidance. Specifically, the 2012 Guidance provides:

Arrangements between the underwriter and an investor purchasing new issue securities from the underwriter (including purchases that are contingent upon the delivery by the issuer to the underwriter of the securities) according to which profits realized from the resale by such investor of the securities are directly or indirectly split or otherwise shared with the underwriter also would, depending on the facts and circumstances (including in particular if such resale occurs reasonably close in time to the original sale by the underwriter to the investor), constitute a violation of the underwriter's fair-dealing obligation under Rule G-17.

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<sup>5</sup> See [MSRB Notice 2009-42](#) (July 14, 2009).

The 2012 Guidance further notes that underwriters should be mindful that, depending on the facts and circumstances, such an arrangement may be inferred from a purposeful but not otherwise justified pattern of transactions or other course of action without the existence of a formal written agreement. Finally, the 2012 Guidance states that such arrangements could also constitute a violation of Rule G-25, on improper use of assets, which, among other things, precludes dealers from sharing, directly or indirectly, in the profits or losses of transactions in municipal securities with or for a customer.<sup>6</sup> Therefore, the 2012 Guidance suggests that underwriters should carefully consider whether any such arrangement, regardless of whether it constitutes a violation of Rule G-25(c), may evidence a potential failure of the underwriter's duty with regard to new issue pricing. Rule G-25 also prohibits dealers from guaranteeing or offering to guarantee customers against loss in transactions in municipal securities with or for customers.<sup>7</sup>

## Prearranged Trading Scenarios

In connection with primary offerings in the municipal securities market, one of the types of prearranged trading that is of concern to the MSRB occurs when, prior to the completion of the distribution of a new issue, a dealer that is not a member of the underwriting syndicate or selling group (a "non-syndicate/selling group dealer") arranges to purchase bonds that are the subject of the distribution from a syndicate/selling group member or an investor at or above the list offering price, typically once the bonds are free to trade. The non-syndicate/selling group dealer enters into the prearranged trade to increase the likelihood that it can purchase the bonds for its own account because an order for an investor, for example, would receive a higher priority allocation than an order placed directly by the non-syndicate/selling group dealer for its own account as determined by the issuer's and syndicate's requirements.<sup>8</sup>

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<sup>6</sup> See MSRB Rule G-25(c).

<sup>7</sup> See MSRB Rule G-25(b). Similar to the discussion above on priority provisions and fair-dealing obligations, although the 2012 Guidance does not apply to selling group members, such dealers could violate Rule G-25 in such a way that, depending on the facts and circumstances, could also constitute a violation of Rule G-17.

<sup>8</sup> An order of the syndicate/selling group member either for its own account or represented as an order for a customer also would have a higher priority than a non-syndicate/selling group dealer's order for its own account. The non-syndicate/selling group dealer may be willing to compensate the syndicate/selling group member or the investor for the benefit of the higher priority allocation because it believes it will be able to sell the bonds at a higher price in the secondary market.

The MSRB understands that this type of prearranged trading in connection with primary offerings may occur in one of the following two scenarios.

Scenario 1 – Prearranged Trade with a Member of the Syndicate or Selling Group

- Prior to the completion of the distribution of the new issue, a non-syndicate/selling group dealer arranges to purchase bonds from a member of the syndicate or selling group at or above the list offering price once the bonds are free to trade.
- As part of the distribution of the new issue, the senior syndicate manager fills an order submitted by the member of the syndicate or selling group. The order submitted to the senior syndicate manager is represented either as an order for the syndicate/selling group member or a customer, not an order for the non-syndicate/selling group dealer, with whom the syndicate/selling group member entered into the prearranged trade.
- The syndicate/selling group member sells the bonds to the non-syndicate/selling group dealer at or above the list offering price as prearranged when the bonds are free to trade.
- The non-syndicate/selling group dealer, whose proprietary order would have been a lower priority than the order placed by the member of the syndicate or selling group (either for that dealer's own account or represented as an order for a customer), engages in the prearranged trade with the intent to circumvent the syndicate's priority provisions, likely involving a misrepresentation by the syndicate/selling group member of the nature of the order it places with the senior syndicate manager, of which the syndicate/selling group member knew or should have known.<sup>9</sup>

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<sup>9</sup> In this scenario, the MSRB assumes that the senior syndicate manager does not know of the prearranged trade between the non-syndicate/selling group dealer and the syndicate/selling group member. Accordingly, as discussed herein, under the 2012 Guidance, the senior syndicate manager would not be in violation of Rule G-17 unless it knowingly accepted the order from the syndicate/selling group that was framed as a retail order or any other order qualified for a higher priority than an order for the non-syndicate/selling group dealer's account, or it did not take reasonable measures to ensure that the order from the syndicate/selling group member was a bona fide retail order or any other order qualified for a higher priority than an order for the non-syndicate/selling group dealer's account, when it effectively was an order for the non-syndicate/selling group dealer to be filled subsequently by a prearranged trade. As noted above, Rule G-11(k) provides that the senior syndicate manager may rely on the information furnished by each dealer that provides the information

### Scenario 2 – Prearranged Trade with an Investor

- Prior to the completion of the distribution of the new issue, a non-syndicate/selling group dealer arranges to purchase bonds from an investor at or above the list offering price once the bonds are free to trade.
- As part of the distribution of the new issue, the senior syndicate manager fills an order submitted by a member of the syndicate or selling group on behalf of the investor.
- The syndicate/selling group member fills an order submitted by the investor who entered into the prearranged trade with the non-syndicate/selling group dealer.
- The investor sells the bonds to the non-syndicate/selling group dealer at or above the list offering price as prearranged when the bonds are free to trade.
- The non-syndicate/selling group dealer, whose proprietary order would have been a lower priority than the order placed by the investor, engages in the prearranged trade with the intent to circumvent the syndicate's priority provisions, likely involving a misrepresentation by the investor of the nature of the order it places with the syndicate/selling group member, and the investor may or may not know of those requirements and/or that intent.<sup>10</sup>

## **Application of MSRB Rules to Prearranged Trading in Connection with Primary Offerings**

As noted above, the purpose of this guidance is to remind dealers of existing MSRB requirements under Rule G-11 and Rule G-17, and to illustrate the applicability of those and other MSRB rules, as well as principles contained in the 2012 Guidance, to dealers, which are not members of an underwriting syndicate or selling group, engaged in certain prearranged trading in connection with primary offerings, as described herein. This guidance,

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required unless the senior syndicate manager knows, or has reason to know, that the information is not true, accurate or complete.

<sup>10</sup> In this scenario, the MSRB assumes that neither the senior syndicate manager nor the syndicate/selling group member knows of the prearranged trade between the non-syndicate/selling group dealer and the investor. Accordingly, neither of those two dealers would be in violation of Rule G-17 as contemplated by the 2012 Guidance. *See id.*

however, is not intended to preclude dealers outside of a syndicate or selling group from entering orders and purchasing bonds for their own accounts in accordance with priority provisions established by the syndicate, or to limit communications between dealers and investors regarding new issues, provided that such discussions do not have the intent of evading applicable MSRB rules. Additionally, this guidance is not intended to prevent dealers or investors from purchasing bonds in a new issue, without the use of a prearranged trade, and then selling them in the secondary market shortly thereafter, or to otherwise discourage ordinary secondary market trading.

Depending on the facts and circumstances, there are multiple places in the scenarios above where dealers could violate MSRB rules.

### **Application to Scenario 1 – Prearranged Trade with a Member of the Syndicate or Selling Group**

- **Non-Syndicate/Selling Group Dealer**: Dealers are subject to Rule G-17 at all times in the conduct of their municipal securities activities. Since the intent of the non-syndicate/selling group dealer is to circumvent compliance with the syndicate's priority provisions, the prearranged trade constitutes a violation of Rule G-17.<sup>11</sup> Specifically, the prearranged trade is deceptive and dishonest because the non-syndicate/selling group dealer effectively is using the syndicate/selling group member as a proxy to receive a higher priority allocation secretly, and indirectly, than the non-syndicate/selling group dealer otherwise could by directly placing an order. To ultimately fill the prearranged trade with the non-syndicate/selling group dealer, the syndicate/selling group member likely has to misrepresent the true nature of an order to the senior syndicate manager and to the issuer by making it appear that the syndicate/selling group member was purchasing bonds to fill an order that would receive a higher priority allocation (either an order for its own account or for a customer) than if the non-syndicate/selling group dealer directly placed an order for its own account.<sup>12</sup>

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<sup>11</sup> The federal securities laws also generally prohibit the use of deception and/or fraud in connection with the purchase or sale of securities. However, the MSRB does not address herein the potential application of such laws to the conduct described herein.

<sup>12</sup> In addition to violating Rule G-17, by colluding with the syndicate/selling group member to circumvent the syndicate's priority provisions, the non-syndicate/selling group dealer may, depending on the facts and circumstances, cause the syndicate/selling group member to violate Rule G-11(b) and/or (k) as noted below.

Additionally, the prearranged trade is unfair because it could cause the senior syndicate manager to fill an order submitted by the member of the syndicate or selling group it might not have filled had it known the bonds sold were actually for the non-syndicate/selling group dealer's account and, correspondingly, could cause customer orders that meet the priority provisions to receive a lower allocation of a new issue than they should have because the order received a higher priority than it otherwise would have. Ultimately, the prearranged trade could cause any customers, who did not receive the allocations they would have but for the prearranged trade, to pay a price greater than the list offering price if they purchase the bonds subsequently in the secondary market.

- Syndicate/Selling Group Member: If a syndicate/selling group member places an order with the senior syndicate manager that is framed as a qualifying retail order or any other order qualified for a higher priority than an order for a dealer's account, when it is effectively an order for a non-syndicate/selling group dealer to be filled subsequently by a prearranged trade, the syndicate/selling group member has violated Rule G-17. Further, if the order placed by the syndicate/selling group member is framed as a qualifying retail order when it is not, the syndicate/selling group member also has violated Rule G-11(k) because it necessarily would have had to misrepresent the information required to be provided to the senior syndicate manager. Finally, depending on the facts and circumstances, the syndicate/selling group member could violate Rule G-11(b) for not disclosing an order for its account, from which it will then sell the bonds to the non-syndicate/selling group dealer in the prearranged trade.

#### **Application to Scenario 2 – Prearranged Trade with an Investor**

- Non-Syndicate/Selling Group Dealer: Similar to the analysis for Scenario 1 above, by engaging in a prearranged trade with an investor, the non-syndicate/selling group dealer causes the investor to create the appearance that the investor is purchasing bonds for its own account or its clients' accounts in accordance with the applicable syndicate restrictions, which is not an accurate representation.<sup>13</sup> As a

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<sup>13</sup> The MSRB notes that investors should consider whether their participation in prearranged trading in connection with primary offerings, as described in this guidance, could cause them to be brokers, dealers or municipal dealers under MSRB rules or the federal securities laws, which, among other things, would subject them to registration with the MSRB and the

result, the non-syndicate/selling group dealer is enabled to purchase bonds for its account that it might not have received if it had placed an order directly with a member of the syndicate or the selling group, due to the lower priority accorded such a dealer order. Accordingly, this prearranged trade by the non-syndicate/selling group member also is deceptive, dishonest and unfair, and constitutes a violation of Rule G-17.

Depending on the facts and circumstances, the non-syndicate/selling group dealer also could violate Rule G-25 in this scenario. By arranging to buy the bonds from the investor, its customer, at a price at or above the list offering price, the non-syndicate/selling group dealer may be guaranteeing a customer against loss (often guaranteeing a profit) in the investor's purchase of the bonds from the syndicate/selling group member in the initial distribution.<sup>14</sup> Also depending on the facts and circumstances, this conduct could constitute a profit-sharing arrangement with an investor that would be a violation of Rule G-17 as provided in the 2012 Guidance.<sup>15</sup>

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MSRB's rules. The SEC has found entities and individuals to be acting as unregistered brokers and to have violated MSRB rules when participating in certain prearranged trading schemes in connection with primary offerings. *See, e.g.,* <https://www.sec.gov/litigation/complaints/2018/comp-pr2018-153.pdf> and <https://www.sec.gov/litigation/complaints/2018/comp-pr2018-153-1.pdf> (charging entities and individuals engaged in "flipping," in which they posed as retail investors to purchase new issue municipal bonds based on a prearranged understanding that the bonds would be sold immediately to dealers for a fee); <https://www.sec.gov/litigation/admin/2018/33-10529.pdf>, <https://www.sec.gov/litigation/admin/2018/34-83840.pdf> and <https://www.sec.gov/litigation/admin/2018/33-10587.pdf> (settling administrative proceedings against a dealer and present and former associated persons of that firm and others for misconduct related to the flipping charges noted herein).

<sup>14</sup> In both scenarios, depending on the facts and circumstances, dealers could also violate other MSRB rules. For example, if a dealer that is party to an agreement with regard to a prearranged trade does not record that transaction or otherwise misrepresents it in its books and records, that dealer would be in violation of [Rule G-8](#), on books and records to be made by brokers, dealers, and municipal securities dealers and municipal advisors.

<sup>15</sup> The scenarios described above are not intended to illustrate all possible prearranged trading fact patterns that would violate Rule G-17 or other MSRB rules. For example, collusion or active participation by a syndicate/selling group member, which uses deception to increase the likelihood that it will receive an allocation of bonds in a primary offering that it might otherwise not be able to obtain by submitting orders for its own account would be contrary to MSRB rules. *See, e.g.,* <https://www.sec.gov/litigation/admin/2018/33-10529.pdf> and <https://www.sec.gov/litigation/admin/2018/34-83840.pdf>.

## Conclusion

As noted above, this guidance is intended to remind dealers of existing MSRB requirements under Rule G-11 and Rule G-17, and to illustrate the applicability of those and other MSRB rules, as well as principles contained in the 2012 Guidance, to dealers that engage in certain prearranged trading in connection with primary offerings. The interpretive guidance provided is not intended to preclude non-syndicate/selling group dealers from submitting orders for their own accounts or ordinary secondary market trading practices of dealers and investors.