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Page 1 of * 118

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. * SR 2022 - * 02

Amendment No. (req. for Amendments *)

Filing by Municipal Securities Rulemaking Board

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input checked="" type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
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Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>
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Rule

<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)
<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)
<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010
Section 806(e)(1) *

Section 806(e)(2) *

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 3C(b)(2) *

Exhibit 2 Sent As Paper Document

Exhibit 3 Sent As Paper Document

Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed Rule Change Consisting of Amendments to MSRB Rule G-19 Regarding Regulation Best Interest for Certain Municipal Securities Activities of Bank Dealers and MSRB Rule G-48 Regarding Quantitative Suitability for Institutional Sophisticated Municipal Market Professionals

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * David Last Name * Hodapp

Title * Director, Market Regulation

E-mail * dhodapp@msrb.org

Telephone * (202) 838-1500 Fax

Signature

Pursuant to the requirements of the Securities Exchange of 1934, Municipal Securities Rulemaking Board has duty caused this filing to be signed on its behalf by the undersigned thereunto duty authorized.

Date 04/29/2022

(Title *)

By Ronald W. Smith

Corporate Secretary

(Name *)

NOTE: Clicking the signature block at right will initiate digitally signing the form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

rsmith@msrb.org
rg
Digitally signed by rsmith@msrb.org
Date: 2022.04.29 13:38:31 -04'00'

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

Form 19b-4 Information *

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

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MSRB-2022-02 Exhibit 1.docx

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A - Notice of Proposed Rule Change, Security-Based Swap Submission, or Advanced Notice by Clearing Agencies *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2- Notices, Written Comments, Transcripts, Other Communications

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MSRB-2022-02 Exhibit 2(a).pdf
MSRB-2022-02 Exhibit 2(b).docx
MSRB-2022-02 Exhibit 2(c).pdf

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit Sent As Paper Document

Exhibit 3 - Form, Report, or Questionnaire

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit Sent As Paper Document

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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MSRB-2022-02 Exhibit 5.docx

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”),¹ and Rule 19b-4 thereunder,² the Municipal Securities Rulemaking Board (“MSRB” or “Board”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change consisting of amendments to: (i) MSRB Rule G-19, on suitability of recommendations and transactions, and (ii) MSRB Rule G-48, on transactions with sophisticated municipal market professionals (“SMMPs”)³ (collectively, the “proposed rule change”). The proposed rule change would align MSRB Rule G-19 to the Commission’s Rule 15l-1 under the Exchange Act (“Regulation Best Interest”)⁴ for certain municipal securities activities of bank dealers⁵ (the “Best Interest Amendments”). In addition, the proposed rule change would amend MSRB Rule G-48 to modify the quantitative suitability obligation of brokers, dealers, and municipal securities dealers (collectively, “dealers” and, individually, each a “dealer”) by eliminating the quantitative suitability obligation for recommendations in circumstances where a dealer does not have actual control or de facto control over the account of an Institutional SMMP (the “Institutional SMMP Amendment”).⁶

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR § 240.19b-4.

³ Under MSRB Rule D-15, on the term sophisticated municipal market professional, “[t]he term ‘sophisticated municipal market professional’ or ‘SMMP’ is generally defined by three essential requirements: the nature of the customer; a determination of sophistication by the broker, dealer or municipal securities dealer []; and an affirmation by the customer; as specified [therein].” See MSRB Rule D-15. See also related discussion under Background and Purpose of the Institutional SMMP Amendment - Background on MSRB Rule D-15 and SMMP Affirmation Requirements near note 37 infra.

⁴ 17 CFR § 240.15l-1; see also Exchange Act Release No. 86031 (June 5, 2019), 84 FR 33318 (July 12, 2019) (File No. S7-07-18) (“Regulation Best Interest Adopting Release”).

⁵ Consistent with MSRB Rule D-8, on the term bank dealer, the term “bank dealer” as used herein means “a municipal securities dealer which is a bank or a separately identifiable department or division of a bank as defined in rule G-1 of the Board.” Such references in this proposed rule shall be collectively to “Bank Dealers” or individually to a “Bank Dealer.” See also MSRB Rule D-11, on the term associated persons (indicating that the term bank dealer as used in MSRB rules shall generally refer to the associated persons of a bank dealer unless the context otherwise requires or a rule of the Board otherwise specifically provides).

⁶ The term “Institutional SMMP” is used here as defined below under the discussion Background and Purpose of the Institutional SMMP Amendment. The Institutional SMMP definition used herein would not encompass any natural person customers who qualify as “retail customers” under the definitions of Regulation Best Interest, such as

Subject to Commission approval, the respective compliance dates for the amendments to MSRB rules included in the proposed rule change will be announced in a regulatory notice published by the MSRB on its website within 30 days of the publication of the Commission's approval order in the Federal Register. Such compliance date for the Best Interest Amendments will be no earlier than one year from the MSRB's publication of the regulatory notice announcing it.⁷ Such compliance date for the Institutional SMMP Amendment will be no earlier than 30 days from the MSRB's publication of the regulatory notice announcing it.

(a) The text of the proposed rule change is attached as Exhibit 5. The text proposed to be added is underlined.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The Board approved the proposed rule change at its meeting on July 21-22, 2021. Questions concerning this filing may be directed to David Hodapp, Director, Market Regulation, Justin Kramer, Assistant Director, Market Regulation, or Prairie Douglas, Attorney II, at 202-838-1500.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

The proposed rule change consists of the Best Interest Amendments to MSRB Rule G-19 and the proposed Institutional SMMP Amendment to MSRB Rule G-48 for the respective purposes further described below.

I. Background and Purpose of the Best Interest Amendments

The proposed Best Interest Amendments would amend MSRB Rule G-19 to extend the obligations of Regulation Best Interest to Bank Dealers when making recommendations to retail customers of municipal securities transactions or investment strategies involving municipal

certain natural persons with significant total assets, who might otherwise meet the status requirements of an SMMP. See note 20 *infra* and related discussion under Background and Purpose of the Institutional SMMP Amendment.

⁷ This one-year minimum timeframe is roughly equivalent to the timeframe provided by the Commission when it adopted Regulation Best Interest. See Regulation Best Interest Adopting Release, 84 FR at 33318, 33400 (setting an effective date of September 10, 2019 and a compliance date of June 30, 2020).

securities (collectively, “retail municipal recommendations” and, individually, each a “retail municipal recommendation”). The Best Interest Amendments are intended to improve investor protection in the municipal securities market by ensuring that retail customers are afforded investor protections under Regulation Best Interest, regardless of whether a retail municipal recommendation received by a retail customer is made by a Broker-Dealer or a Bank Dealer.⁸

A. Background on the Commission’s Regulation Best Interest

On June 5, 2019, the SEC adopted Regulation Best Interest, which established a new standard of conduct for broker-dealers, and the natural persons who are associated persons of such broker-dealers (collectively, “Broker-Dealers” and, individually, each a “Broker-Dealer”), when making a recommendation to a retail customer of any securities transaction or investment strategy involving securities.⁹ As defined in Regulation Best Interest, the term “retail customer” generally refers to any natural person, or the legal representative of such person, who receives and uses a recommendation from a Broker-Dealer primarily for personal, family, or household purposes.¹⁰ Regulation Best Interest enhanced the Broker-Dealer standard of conduct beyond existing suitability obligations, such as those required by MSRB Rule G-19, on suitability, for such retail customers and aligned the applicable standard of conduct with the reasonable expectations of retail customers.¹¹ In this regard, Regulation Best Interest imposes the following “general obligation” on Broker-Dealers, stating a broker, dealer, or a natural person who is an

⁸ The term “Broker-Dealer” is used here as defined below under the following discussion Background on the Commission’s Regulation Best Interest.

⁹ See, generally, Regulation Best Interest Adopting Release (citation at note 4 supra). In response, on May 1, 2020, the MSRB filed a proposed rule change with the Commission to harmonize Regulation Best Interest with certain MSRB rules applicable to related municipal securities activities of Broker-Dealers. See Exchange Act Release No. 88828 (May 6, 2020), 85 FR 28082, File No. SR-MSRB-2020-02 (hereinafter, the “Broker-Dealer Harmonization Filing”), available at <https://msrb.org/-/media/Files/SEC-Filings/2020/MSRB-2020-02-Notice.ashx>?. The Commission approved these proposed amendments on June 25, 2020. See Exchange Act Release No. 89154 (June 25, 2020), 85 FR 39613 (July 1, 2020), File No. SR-MSRB-2020-02, available at <https://msrb.org/-/media/Files/SEC-Filings/2020/MSRB-2020-02-Federal-Register.ashx>?

¹⁰ 17 CFR § 240.151-1(b)(1) (“Retail customer means a natural person, or the legal representative of such natural person, who (i) [r]eceives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and (ii) [u]ses the recommendation primarily for personal, family, or household purposes.”) For discussion of what it means for a retail customer to “use” a recommendation, see the SEC staff’s Frequently Asked Questions on Regulation Best Interest, available at <https://www.sec.gov/tm/faq-regulation-best-interest>.

¹¹ Regulation Best Interest Adopting Release, 84 FR at 33319.

associated person of a broker or dealer, when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer, shall act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.¹²

B. Discussion of Regulation Best Interest's Current Applicability to Bank Dealers

By its terms, Regulation Best Interest does not apply to retail municipal recommendations made by Bank Dealers, because Bank Dealers in exempted securities have an exception from Broker-Dealer status under the Act and Regulation Best Interest applies only to Broker-Dealers. As a result, Bank Dealers presently are not required to comply with Regulation Best Interest and, therefore, retail investors may not benefit from its enhanced standard of conduct when receiving recommendations from Bank Dealers.¹³

C. Application of Regulation Best Interest to Bank Dealers

The proposed Best Interest Amendments would amend MSRB Rule G-19 to require a Bank Dealer to comply with Regulation Best Interest to the same extent as if it were a Broker-Dealer when making a retail municipal recommendation. Consequently, a Bank Dealer would have to act in the best interest of the retail customer at the time a retail municipal recommendation is made, without placing the financial or other interests of the Bank Dealer

¹² 17 CFR § 240.151-1(a)(1). Regulation Best Interest provides that this general obligation is satisfied only if a Broker-Dealer complies with four component obligations: (i) an obligation to make certain prescribed disclosures, before or at the time of the recommendation, about the recommendation and the relationship between the retail customer and the Broker-Dealer (the "Disclosure Obligation") (see 17 CFR § 240.151-1(a)(2)(i)); (ii) an obligation to exercise reasonable diligence, care, and skill in making a recommendation (the "Care Obligation") (see 17 CFR § 240.151-1(a)(2)(ii)); (iii) an obligation to establish, maintain, and enforce written policies and procedures reasonably designed to address conflicts of interest (the "Conflict-of-Interest Obligation") (see 17 CFR § 240.151-1(a)(2)(iii)); and (iv) an obligation to establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest (the "Compliance Obligation") (see 17 CFR § 240.151-1(a)(2)(iv)).

¹³ See Broker-Dealer Harmonization Filing, 85 FR at 28083, n. 5 (discussing how Bank Dealers are not subject to Regulation Best Interest by the terms of the SEC's rules and indicating the Board's intent to issue a request for comment regarding extending the requirements of Regulation Best Interest to Bank Dealers). Notably, all Bank Dealer recommendations, including retail municipal recommendations, are presently subject to the longstanding suitability obligations provided by MSRB rules, including MSRB Rule G-19 and, when applicable, MSRB Rule G-48.

ahead of the interest of the retail customer. Correspondingly, the Bank Dealer would have to comply with the Commission's component obligations of Regulation Best Interest to the same extent as if it were a Broker-Dealer, including Regulation Best Interest's Disclosure Obligation,¹⁴ Care Obligation,¹⁵ Conflict-of-Interest Obligation,¹⁶ and Compliance Obligation.¹⁷ Under the proposed Best Interest Amendments, the component obligations of Regulation Best Interest would apply to those municipal securities activities associated with a retail municipal recommendation within the overall context of a Bank Dealer business model. The MSRB believes that any SEC guidance with respect to the understanding and application of Regulation Best Interest would be equally applicable to Bank Dealers.

1. Application of the Disclosure Obligation to Bank Dealers

Consistent with Regulation Best Interest's Disclosure Obligation, the proposed Best Interest Amendments would require a Bank Dealer, prior to or at the time of the retail municipal recommendation, to provide to its retail customer, in writing, full and fair disclosure of: (a) All material facts relating to the scope and terms of the relationship with the retail customer, including: (i) That the Bank Dealer is acting as a municipal securities dealer with respect to the retail municipal recommendation; (ii) The material fees and costs that apply to the retail customer's transactions, holdings, and accounts; and (iii) The type and scope of services provided to the retail customer, including any material limitations on the securities or investment strategies involving securities that may be recommended to the retail customer;¹⁸ and (b) All material facts relating to conflicts of interest that are associated with the retail municipal recommendation.

2. Application of the Care Obligation to Bank Dealers

Consistent with Regulation Best Interest's Care Obligation, the proposed Best Interest Amendments would require a Bank Dealer to exercise reasonable diligence, care, and skill to: (a)

¹⁴ 17 CFR § 240.151-1(a)(2)(i).

¹⁵ 17 CFR § 240.151-1(a)(2)(ii).

¹⁶ 17 CFR § 240.151-1(a)(2)(iii).

¹⁷ 17 CFR § 240.151-1(a)(2)(iv).

¹⁸ For example, if the applicable legal charter of a Bank Dealer only permits a Bank Dealer to conduct municipal securities activities or, in fact, a Bank Dealer's business model is limited to municipal securities activities, then the Bank Dealer generally would be required to accurately disclose the fact that it only engages in transactions involving municipal securities and, therefore, will only make recommendations to a retail customer regarding transactions involving municipal securities. See also note 19 *infra* (discussing the Compliance Obligation pursuant to the Best Interest Amendments for Bank Dealers who do not engage in any retail municipal recommendations).

Understand the potential risks, rewards, and costs associated with any retail municipal recommendation, and have a reasonable basis to believe that a retail municipal recommendation could be in the best interest of at least some retail customers; (b) Have a reasonable basis to believe that the retail municipal recommendation is in the best interest of a particular retail customer, based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation, and does not place the financial or other interest of the Bank Dealer ahead of the interest of the retail customer; (c) Have a reasonable basis to believe that a series of retail municipal recommendations, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile and does not place the financial or other interest of the Bank Dealer ahead of the interest of the retail customer.

3. Application of the Conflict-of-Interest Obligation to Bank Dealers

Consistent with Regulation Best Interest's Conflict-of-Interest Obligation, the proposed Best Interest Amendments would require a Bank Dealer to establish, maintain, and enforce written policies and procedures reasonably designed to: (a) Identify and at a minimum disclose, in accordance with its Disclosure Obligation, or eliminate, all conflicts of interest associated with such retail municipal recommendations; (b) Identify and mitigate any conflicts of interest associated with such retail municipal recommendations that create an incentive for a natural person who is an associated person of the Bank Dealer to place the interests of the Bank Dealer or such associated person ahead of the interest of the retail customer; (c)(i) Identify and disclose any material limitations placed on the securities or investment strategies involving securities that may be recommended to a retail customer and any conflicts of interest associated with such limitations, in accordance with its Disclosure Obligation, and (ii) Prevent such limitations and associated conflicts of interest from causing the Bank Dealer to make retail municipal recommendations that place the interest of the Bank Dealer ahead of the interest of the retail customer; and (d) Identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific municipal securities or specific types of municipal securities within a limited period of time.

4. Application of the Compliance Obligation to Bank Dealers

Consistent with Regulation Best Interest's Compliance Obligation, the proposed Best Interest Amendments would require a Bank Dealer to establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest.¹⁹

¹⁹ If a Bank Dealer's business model is such that it and its associated persons are not permitted to make any retail municipal recommendations, then a Bank Dealer may opt not to establish policies and procedures outlining the affirmative regulatory obligations pursuant to the Disclosure Obligation, Care Obligation, and Conflict of Interest Obligation. However, it would be prudent for a Bank Dealer to have policies and procedures that make clear that, prior to permitting the making of any such retail municipal recommendations, the Bank Dealer would need to establish policies and

D. Purpose and Intent of the Best Interest Amendments

The MSRB is proposing the Best Interest Amendments to MSRB Rule G-19 for purposes of enhancing the standard of investor protection in the municipal securities market and enhancing fairness and efficiency in the municipal securities market by promoting regulatory parity among Bank Dealers and Broker-Dealers. Specific to enhancing the standard of investor protection, the MSRB believes that all retail customers receiving a retail municipal recommendation should benefit from the enhanced investor protections afforded by Regulation Best Interest, regardless of whether such a retail customer is a customer of a Broker-Dealer or a Bank Dealer. Currently, retail customers of Bank Dealers are not afforded the protections of Regulation Best Interest when receiving a retail municipal recommendation from a Bank Dealer. The proposed Best Interest Amendments would require a Bank Dealer to comply with the enhanced standard of conduct required by Regulation Best Interest and, thereby, improve overall investor protection in the municipal securities market.

Specific to promoting regulatory parity, the MSRB believes that the proposed Best Interest Amendments would establish a uniform regulatory standard in the municipal securities market by requiring the same standard of conduct for Bank Dealers and Broker-Dealers when making retail municipal recommendations. This uniform standard would enhance the fairness and efficiency of the municipal securities market by ensuring Bank Dealers have regulatory obligations and burdens when engaging in retail municipal recommendations that are equivalent to the regulatory obligations and burdens of Broker-Dealers when engaging in the same municipal securities activities. This uniformity would better ensure that Bank Dealers do not have a competitive advantage in the municipal securities market by operation of a less burdensome regulatory standard of conduct and, thereby, mitigate the potential for regulatory arbitrage.

II. Background and Purpose of the Institutional SMMP Amendment

The proposed Institutional SMMP Amendment would amend MSRB Rule G-48 to modify the current obligation to perform a quantitative suitability analysis for recommendations where the dealer does not have actual control or de facto control over the account of an SMMP who is not a retail customer under Regulation Best Interest (collectively, “Institutional SMMPs” and, individually, each an “Institutional SMMP”).²⁰

procedures reasonably designed to ensure compliance with the Best Interest Amendments to MSRB Rule G-19.

²⁰ See supra note 10 for the applicable definition of “retail customer” and related citation. Any customer meeting such definition of retail customer pursuant to Regulation Best Interest would not be considered an Institutional SMMP for the purposes of the proposed Institutional SMMP Amendment and its modification to MSRB Rule G-48. For purposes of MSRB rules, such a customer meeting the definition of a “retail customer” would receive the protections afforded by Regulation Best Interest.

Similar to the reduced customer-specific suitability obligations currently afforded to Institutional SMMPs under MSRB Rule G-48(c), the MSRB believes that dealers transacting with Institutional SMMPs should have similarly reduced quantitative-suitability obligations in instances where the dealer does not have actual control or de facto control over the account of an Institutional SMMP. This modification would effectively revert the quantitative suitability standard for Institutional SMMPs back to the longstanding standard that was in place under MSRB rules prior to June 30, 2020.²¹ The proposed Institutional SMMP Amendment is intended to improve the efficiency of the municipal securities market without eroding investor protection by aligning the compliance burden associated with certain recommendations made by dealers to the reasonable expectations and capabilities of Institutional SMMPs – who by their nature are more sophisticated, non-natural-person customers and must affirmatively indicate their capacity to (i) exercise independent judgment and (ii) access material information.²²

A. Background on MSRB Rule G-19’s Quantitative Suitability Requirements

MSRB Rule G-19 sets the MSRB’s baseline investor protection standards regarding the suitability of recommendations made by dealers to their customers of purchases, sales, or exchanges of municipal securities that are not subject to Regulation Best Interest. Among other requirements, Supplementary Material .05 of MSRB Rule G-19 enumerates three components of a dealer’s suitability analysis when recommending a transaction or investment strategy involving a municipal security or municipal securities to a non-retail customer (i.e., a recommendation that is not subject to Regulation Best Interest).²³ As further defined in the text of the rule, MSRB Rule G-19 provides that a dealer’s suitability obligation is composed of (i) reasonable-basis suitability, (ii) customer-specific suitability, and (iii) quantitative suitability. Most relevant to the proposed Institutional SMMP Amendment of this proposed rule change, quantitative suitability requires a dealer to have a reasonable basis for believing that a series of

²¹ See Broker-Dealer Harmonization Filing, 85 FR at 28082, n. 4. The MSRB notes that it has had a long held prohibition against “churning,” and the MSRB formally “recast” this prohibition as quantitative suitability through an amendment to MSRB Rule G-19 approved by the SEC in 2014. See Exchange Act Release No. 71665 (Mar. 7, 2014), 79 FR 2432 (Mar. 13, 2014), File No. SR-MSRB-2013-07 (discussing the then-existing MSRB prohibition on churning and a proposed rule change to recast this prohibition using the phrase “quantitative suitability”), available at <http://www.msrb.org/~media/Files/SEC-Filings/2013/MSRB-2013-07-Fed-Reg-Approval.ashx?la=en&hash=AEDA0B5509630E25473E9F6F3A3F9C34>.

²² See MSRB Rule G-48(c). See also related discussion *infra* under Background and Purpose of the Institutional SMMP Amendment - Background on MSRB Rule D-15 and SMMP Affirmation Requirements.

²³ See the Broker-Dealer Harmonization Filing, 85 FR at 28084. The Broker-Dealer Harmonization Filing amended MSRB Rule G-19 to provide that the rule does not apply to recommendations subject to Regulation Best Interest.

recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in MSRB Rule G-19.²⁴ No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a dealer has violated the quantitative suitability obligation.²⁵

Pursuant to the amendments effectuated by the Broker-Dealer Harmonization Filing, discussed above and effective as of June 30, 2020, the quantitative suitability obligation of MSRB Rule G-19 no longer incorporates an element of control in relation to a customer's account.²⁶ As a result, dealers are currently obligated to conduct a quantitative suitability analysis under MSRB Rule G-19 when making recommendations to Institutional SMMPs, even in instances where the dealer does not have actual control or de facto control over the account. The obligation applies notwithstanding the fact that Institutional SMMPs self-identify under MSRB Rule G-48 and MSRB Rule D-15 as having the willingness and requisite investment sophistication to, for example, independently evaluate the recommendations of a dealer and the quality of a dealer's execution, as further discussed below.²⁷

B. Background on MSRB Rule G-48 and Modified Regulatory Obligations

MSRB Rule G-48 provides for modified dealer regulatory obligations under MSRB rules when dealing with certain customers that meet the definition of a Sophisticated Municipal

²⁴ MSRB Rule G-19, Supplementary Material .05(c).

²⁵ Id.

²⁶ In other words, as of June 30, 2020, if the obligations of MSRB Rule G-19 attach to a dealer's recommendation, then the investor protections regarding quantitative suitability apply regardless of whether the dealer making the recommendation exercises any actual control or de facto control over the customer's account. The Broker-Dealer Harmonization Filing amended this language of Supplementary Material .05(c) to eliminate such control requirements, effectively extending the requirements of quantitative suitability to any customer account. See Broker-Dealer Harmonization Filing, 85 FR at 28084. June 30, 2020 was the compliance date for the amendments enacted by the Broker-Dealer Harmonization Filing. See Broker-Dealer Harmonization Filing, 85 FR at 28082, n. 4. Pursuant to the Broker-Dealer Harmonization Filing, the MSRB also notes that this quantitative suitability obligation applies uniformly to any dealer (i.e., the same regulatory obligations apply to both Broker-Dealers and Bank Dealers).

²⁷ See MSRB Rule D-15(c) (requiring Institutional SMMPs to "affirmatively indicate," among other things, that it is exercising independent judgment in evaluating (A) the recommendations of the dealer and (B) the quality of execution of the customer's transactions by the dealer).

Market Participant²⁸ (i.e., an SMMP). More specifically, when transacting with an SMMP customer, Rule G-48 modifies aspects of a dealer's baseline regulatory obligations in terms of: (i) time of trade disclosures,²⁹ (ii) transaction pricing,³⁰ (iii) bona fide quotations,³¹ (iv) best execution,³² and (v) suitability.³³ The modified regulatory obligations afforded to SMMPs under MSRB rules are intended to account for the distinct capabilities of certain sophisticated, non-retail customers and the varied types of dealer-customer relationships occurring in the municipal securities market.³⁴

Most relevant to the proposed Institutional SMMP Amendment, Rule G-48(c) currently modifies the suitability requirements of MSRB Rule G-19 by eliminating the requirement for dealers to conduct a customer-specific suitability analysis for recommendations made to an Institutional SMMP.³⁵ The operative provision of MSRB Rule G-48 provides that, “[w]hen

²⁸ See discussion under Background and Purpose of the Institutional SMMP Amendment - Background on MSRB Rule D-15 and SMMP Affirmation Requirements near note 37 infra (discussing the definition of Sophisticated Municipal Market Participant under MSRB Rule D-15).

²⁹ MSRB Rule G-48(a) (“The broker, dealer, or municipal securities dealer shall not have any obligation under Rule G-47 to ensure disclosure of material information that is reasonably accessible to the market.”)

³⁰ MSRB Rule G-48(b).

³¹ MSRB Rule G-48(d) (“The broker, dealer, or municipal securities dealer disseminating an SMMP’s ‘quotation’ as defined in Rule G-13, which is labeled as such, shall apply the same standards regarding quotations described in Rule G-13(b) as if such quotations were made by another broker, dealer, or municipal securities dealer.”)

³² MSRB Rule G-48(e) (“The broker, dealer, or municipal securities dealer shall not have any obligation under Rule G-18 to use reasonable diligence to ascertain the best market for the subject security and buy or sell in that market so that the resultant price to the SMMP is as favorable as possible under prevailing market conditions.”)

³³ MSRB Rule G-48(c).

³⁴ See, e.g., Exchange Act Release No. 67064 (May 25, 2012), 77 FR 32704 (June 1, 2012), File No. SR-MSRB-2012-05 (May 25, 2012) (approving an MSRB proposed rule change to relax certain qualifications for a dealer to afford a customer SMMP status in light of market developments regarding the increased availability of municipal securities market information and the desire of certain institutional customers to access alternative trading systems).

³⁵ Id. The amendments to MSRB Rule G-48 enacted by the Broker-Dealer Harmonization Filing carved out recommendations to customers that are subject to Regulation Best

making a recommendation subject to Rule G-19 and not Regulation Best Interest, Rule 151-1 under the Act, a broker, dealer, or municipal securities dealer shall not have any obligation under Rule G-19 to perform a customer-specific suitability analysis.”³⁶ This relaxed customer-specific suitability obligation is generally aligned with the “independent judgment” affirmations a customer seeking SMMP status makes under MSRB Rule D-15. The proposed Institutional SMMP Amendment would likewise relax the quantitative suitability obligation for similar reasons, as further described in the following sections.³⁷

C. Background on MSRB Rule D-15 and SMMP Affirmation Requirements

MSRB Rule G-48 incorporates the definition of SMMP under MSRB Rule D-15 for purposes of defining which customers do (or do not) qualify as an SMMP for purposes of Rule G-48 and, therefore, MSRB Rule D-15 establishes the scope of potential customers who might qualify for MSRB Rule G-48’s modified obligations. The SMMP definition of MSRB Rule D-15 enumerates three definitional components, which separately address: (i) the minimum qualifying traits and characteristics of an SMMP customer;³⁸ (ii) that a dealer must develop a reasonable basis for determining whether a customer has the requisite level of expertise and sophistication to be deemed an SMMP customer (the “SMMP Reasonable Basis Determination”);³⁹ and (iii) what affirmations a customer must communicate to the dealer regarding its own investment judgment and access to information in order to be appropriately deemed an SMMP customer (the “SMMP

Interest from the rule’s modified standards. See Broker-Dealer Harmonization Filing, 85 FR at 28084-85.

³⁶ MSRB Rule G-48(c).

³⁷ See Exchange Act Release No. 71665 (Mar. 7, 2014), 79 FR 14321 (Mar. 13, 2014), File No. SR-MSRB-2013-07 (Sept. 17, 2013) (codifying the relaxed customer-specific suitability obligation for recommendations made to SMMPs in MSRB Rule G-48 and the actual control or de facto control requirement, thereafter eliminated in 2020 as described herein, for the applicability of quantitative suitability to recommendations made to customers in MSRB Rule G-19).

³⁸ MSRB Rule D-15(a). A customer is only eligible to be treated as an SMMP if the customer is: (i) a bank, savings and loan association, insurance company, or registered investment company, (ii) a registered investment advisor, or (iii) a person or entity with total assets of at least \$50 million.

³⁹ MSRB Rule D-15(b). A customer is only eligible to be treated as an SMMP if the dealer has developed a reasonable basis to believe that the customer is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions and investment strategies in municipal securities. In addition, Supplementary Material .01 of MSRB Rule D-15 states that, as part of the reasonable-basis analysis, the dealer should consider the amount and type of municipal securities owned or under management by the customer.

Customer Affirmations”).⁴⁰ In terms of the SMMP Customer Affirmations, MSRB Rule D-15(c) provides that the customer must affirmatively indicate to the dealer that (i) it is exercising independent judgment in evaluating the recommendations of the dealer; the quality of execution of the customer’s transactions by the dealer; and the transaction price for non-recommended secondary market agency transactions as to which the dealer’s services have been explicitly limited to providing anonymity, communication, order matching and/or clearance functions and the dealer does not exercise discretion as to how or when the transactions are executed;⁴¹ and (ii) it has timely access to material information that is available publicly through established industry sources as defined in MSRB Rule G-47(b)(i) and MSRB Rule G-47(b)(ii) (i.e., “material information” from “established industry sources,” such as EMMA website information and rating agency reports).⁴²

Thus, an institutional customer who self-identifies as an SMMP has freely affirmed to a dealer its willingness to be treated as a sophisticated customer with the capacity and resources to exercise its own independent judgment. In this way, the SMMP Customer Affirmations are designed to ensure that any customer treated as an SMMP has affirmatively and knowingly provided the grounds on which a dealer may afford such SMMP customer lesser protections under certain MSRB rules. As an additional investor protection safeguard beyond the requirement for SMMP Customer Affirmations, the SMMP Reasonable Basis Determination also requires a dealer to have a reasonable basis to believe that an SMMP customer is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions and investment strategies in municipal securities.⁴³ In this way, the SMMP Reasonable Basis Determination further ensures that an Institutional SMMP does in fact possess a more sophisticated understanding of the municipal securities market. Importantly, the proposed Institutional SMMP Amendment would not alter the SMMP Customer Affirmations, the SMMP Reasonable Basis Determination, nor any of the other definitional elements of MSRB Rule D-15.

D. Purpose and Intent of the Institutional SMMP Amendment to MSRB Rule G-48

⁴⁰ MSRB Rule D-15(c).

⁴¹ See MSRB Rule D-15(c)(1) (“The customer must affirmatively indicate that it: (1) is exercising independent judgment in evaluating: (A) the recommendations of the dealer; (B) the quality of execution of the customer’s transactions by the dealer; and (C) the transaction price for non-recommended secondary market agency transactions as to which (i) the dealer’s services have been explicitly limited to providing anonymity, communication, order matching and/or clearance functions and (ii) the dealer does not exercise discretion as to how or when the transactions are executed . . .”).

⁴² See MSRB Rule D-15(c)(2) (“The customer must affirmatively indicate that it . . . (2) has timely access to material information that is available publicly through established industry sources as defined in Rule G-47(b)(i) and (ii).”)

⁴³ See MSRB Rule D-15(b) and Rule D-15 Supplementary Material .01.

The proposed Institutional SMMP Amendment would amend MSRB Rule G-48 to modify the quantitative suitability obligations of dealers when effecting transactions for their Institutional SMMPs. The proposed Institutional SMMP Amendment would require a dealer to conduct a quantitative suitability analysis only in situations where the dealer has actual control or de facto control over an Institutional SMMP's account.⁴⁴ As stated above, the proposed amendments to MSRB Rule G-48 would narrowly reinstate the scope of suitability protections afforded to Institutional SMMPs in effect prior to the amendments effectuated by the Broker-Dealer Harmonization Filing and so should be a familiar regulatory concept to dealers and Institutional SMMPs alike.⁴⁵ More importantly, because each Institutional SMMP must self-identify as an SMMP by making the SMMP Customer Affirmations, as well as must fulfill the requirements associated with a dealer's SMMP Reasonable Basis Determination, the MSRB believes that the proposed Institutional SMMP Amendment will ease a regulatory burden on dealers that effectively replicates the sort of analysis an Institutional SMMP is willing and capable of performing itself. As a result, the proposed Institutional SMMP Amendment would align the compliance burden associated with certain recommendations made by dealers to the reasonable expectations and capabilities of Institutional SMMPs.

While the investor protection benefits associated with requiring dealers to perform a potentially duplicative suitability analysis can be appropriate in other circumstances,⁴⁶ the MSRB believes that the compliance burden associated with performing a quantitative suitability analysis on recommendations made to Institutional SMMPs outweighs the potential marginal investor protection benefits. In this way, the proposed Institutional SMMP Amendment would promote efficiency in the municipal securities market by eliminating a regulatory burden on dealers that generally provides a duplicative or unneeded analyses in supplement of an Institutional SMMPs' own independent and informed judgment, and, consequently, the proposed

⁴⁴ Where a dealer exercises actual control or de facto control over an Institutional SMMP's account, the dealer would still be required to perform a quantitative suitability analysis in accordance with Supplementary Material .05 of MSRB Rule G-19. Relatedly, if an Institutional SMMP limitedly provides its customer affirmation on a trade-by-trade basis, then the dealer would be required to comply with all aspects of MSRB Rule G-19, including both the quantitative suitability requirement and the customer-specific suitability requirement, for those recommendations for which the Institutional SMMP did not provide the applicable customer affirmation. See Supplementary Material .02 of MSRB Rule D-15 (discussing trade-by-trade affirmations).

⁴⁵ See supra note 21 and related discussion.

⁴⁶ For example, the MSRB believes that the obligation to perform quantitative suitability analyses under MSRB rules remains appropriate, regardless of the potential for such duplication, in circumstances of recommendations made to retail customers; non-retail, institutional customers who fail to meet the characteristics of an SMMP; and/or non-retail customers who have declined to make the affirmations necessary to be appropriately deemed an SMMP.

Institutional SMMP Amendment would allow dealers to redirect the resources associated with this regulatory burden to other more productive market activities.

(b) Statutory Basis

The MSRB believes that the proposed rule change is consistent with Section 15B(b)(2) of the Act,⁴⁷ which provides that the Board shall propose and adopt rules to effect the purposes of this title with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers and advice provided to or on behalf of municipal entities or obligated persons by brokers, dealers, municipal securities dealers, and municipal advisors with respect to municipal financial products, the issuance of municipal securities, and solicitations of municipal entities or obligated persons undertaken by brokers, dealers, municipal securities dealers, and municipal advisors.⁴⁸

Section 15B(b)(2)(C) of the Act⁴⁹ provides that the MSRB's rules shall be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest.⁵⁰ The MSRB believes the proposed rule change is consistent with Section 15B(b)(2)(C) of the Act⁵¹ for the following reasons.

I. Statutory Basis for the Best Interest Amendments

The proposed Best Interest Amendments are consistent with Section 15B(b)(2)(C) of the Act⁵² because the amendments would: foster cooperation and coordination with regulators; prevent fraudulent and manipulative acts and practices; protect investors; remove impediments to and perfect the mechanism of a free and open market in municipal securities; and promote capital formation in the municipal securities market.

A. Fostering Cooperation and Coordination with Regulators

⁴⁷ 15.U.S.C. 78o-4(b)(2).

⁴⁸ Id.

⁴⁹ 15 U.S.C. 78o-4(b)(2)(C).

⁵⁰ Id.

⁵¹ Id.

⁵² Id.

The proposed Best Interest Amendments would foster cooperation and coordination with regulators by more tightly aligning the suitability obligations of MSRB Rule G-19 with the suitability obligations of Regulation Best Interest. By providing a uniform standard for all types of dealers, this alignment of the regulatory scheme applicable to retail municipal recommendations will foster greater cooperation and coordination among the MSRB and the SEC, as well as greater cooperation and coordination among the authorities that examine Broker-Dealers and Bank Dealers for compliance with MSRB rules.

B. Protecting Investors and Preventing Fraudulent and Manipulative Act and Practices

The proposed Best Interest Amendments would protect investors and prevent fraudulent and manipulative acts and practices by extending the enhanced standards of conduct required by Regulation Best Interest to the retail municipal recommendations of Bank Dealers. As noted by the Commission in the adopting release for Regulation Best Interest, Regulation Best Interest enhances the broker-dealer standard of conduct beyond existing suitability obligations, and aligns the standard of conduct with retail customers' reasonable expectations by requiring broker-dealers, among other things, to: act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer; and address conflicts of interest by establishing, maintaining, and enforcing policies and procedures reasonably designed to identify and fully and fairly disclose material facts about conflicts of interest, and in instances where we have determined that disclosure is insufficient to reasonably address the conflict, to mitigate or, in certain instances, eliminate the conflict.⁵³

In addition, the Commission stated the enhancements contained in Regulation Best Interest are designed to improve investor protection by enhancing the quality of broker-dealer recommendations to retail customers and reducing the potential harm to retail customers that may be caused by conflicts of interest.⁵⁴ For the same reasons, the MSRB believes that extending Regulation Best Interest to the retail municipal recommendations of Bank Dealers would prevent potential fraudulent and manipulative acts and practices and promote the protection of the retail customers of Bank Dealers.

C. Removing Impediments and Perfecting the Mechanisms of a Free and Open Market

The proposed Best Interest Amendments would remove impediments to and perfect the mechanism of a free and open market in municipal securities by applying a uniform regulatory standard for retail municipal recommendations that would promote parity regarding the regulatory obligations of Broker-Dealers and Bank Dealers and, thereby, reduce potential confusion among market participants as to which standard of conduct applies.

⁵³ Regulation Best Interest Adopting Release, 84 FR at 33318.

⁵⁴ Regulation Best Interest Adopting Release, 84 FR at 33321.

D. Promoting Capital Formation

The proposed Best Interest Amendments would not have a deleterious effect on capital formation in the municipal securities market and would have the potential to improve capital formation for the following reasons. Similar to the Commission’s reasoning in its adoption of Regulation Best Interest,⁵⁵ the enhanced obligations of Regulation Best Interest may increase the efficiency of retail municipal recommendations and increase the attractiveness of Bank Dealer services for those retail customers who do not invest with a Bank Dealer because recommendations made by bank dealers are not currently subject to the additional standards of investor protection afforded by Regulation Best Interest. Additionally, by adopting a uniform regulatory standard for retail municipal recommendations across all dealers (i.e., across Bank Dealers and Broker-Dealers), the overall attractiveness of the municipal securities activities of dealers may improve. Consequently, if more retail customers are more willing to participate in municipal securities activities, then the proposed Best Interest Amendments would promote capital formation in the municipal securities market.

II. Statutory Basis for the Institutional SMMP Amendment

The proposed Institutional SMMP Amendment is consistent with Section 15B(b)(2)(C)⁵⁶ of the Act because the amendment would facilitate transactions in municipal securities and remove impediments to and perfect the mechanism of a free and open market in municipal securities, while not compromising investor protection.

The proposed Institutional SMMP Amendment would facilitate transactions in municipal securities and remove impediments to and perfect the mechanism of a free and open market in municipal securities by reducing a compliance burden on dealers. The modification of a dealer’s suitability obligations to eliminate the current requirement to perform a quantitative suitability analysis for recommendations in circumstances where the dealer does not have actual control or de facto control over an Institutional SMMP’s account will eliminate what could potentially be duplicative analyses undertaken by dealers on behalf of Institutional SMMPs – analyses which Institutional SMMPs have already affirmed their capacity and expertise to conduct for themselves, and which the Institutional SMMPs presumably have taken upon themselves to perform. In this regard, the proposed Institutional SMMP Amendment will remove an impediment to the mechanisms of a free and open market in municipal securities and promote greater efficiency. By eliminating this regulatory burden, the proposed Institutional SMMP

⁵⁵ Regulation Best Interest Adopting Release, 84 FR at 33462 (“The possibility that Regulation Best Interest may increase the efficiency of the recommendations provided by the associated persons of the broker-dealer may enhance the attractiveness of broker-dealer services for those investors who currently do not invest through broker-dealers. . . . If retail customers are more willing to participate in the securities markets through broker-dealers, Regulation Best Interest would have a positive effect on capital formation.”)

⁵⁶ 15 U.S.C. 78o-4(b)(2)(C).

Amendment would allow dealers to redirect the resources associated with this regulatory burden to other more productive market activities. As a separate, but related benefit, the MSRB believes that the Institutional SMMP Amendment would allow dealers to more efficiently serve those Institutional SMMPs who may be seeking relatively greater transaction activity and/or are more comfortable taking on the risks associated with more frequent transaction activity.

The MSRB believes that the proposed Institutional SMMP Amendment to MSRB Rule G-48 will not compromise investor protections. The MSRB believes that allowing dealers to make recommendations to their Institutional SMMP customers without the burden of performing a quantitative suitability analysis is consistent with the SMMP Customer Affirmations and dealers' SMMP Reasonable Basis Determination. More specifically, the SMMP Customer Affirmations ensure that an Institutional SMMP itself believes that it has the requisite knowledge and judgment to be afforded SMMP status; and, as an additional safeguard to investor protection, the SMMP Reasonable Basis Determination separately ensures that the dealer also has a reasonable basis to conclude that an Institutional SMMP has the knowledge and sophistication to be treated as a SMMP based on supplemental factors beyond just the SMMP Customer Affirmations. If either definitional prong is not met, a dealer is not permitted to afford an institutional customer the status of a SMMP. Therefore, the MSRB believes that the proposed Institutional SMMP Amendment is generally consistent with an Institutional SMMP's more sophisticated understanding of (i) the commercial nature of its relationship with a dealer and (ii) the lesser regulatory standards of conduct governing the SMMP-dealer relationship.

In addition, the proposed Institutional SMMP Amendment would incorporate the concepts of actual control or de facto control. Reinstating these control elements would help address potential scenarios in which the ability of an Institutional SMMP to exercise independent judgment is undermined or circumvented, such as when a dealer may not have formal discretionary authority over an Institutional SMMP's account, but nevertheless exercises de facto control over the account to, for example, engage in churning activity in clear contravention of an Institutional SMMP's investment interests.⁵⁷ The MSRB believes that incorporating the actual control or de facto control elements maintains baseline investor protections for Institutional SMMPs in such scenarios of greater dealer impropriety or intentional wrongdoing.

The MSRB also notes that new institutional customers, who otherwise would qualify as SMMPs but desire the additional investor protections afforded by quantitative suitability under MSRB Rule G-19, can decline to provide the required affirmations under MSRB Rule D-15.⁵⁸ Similarly, existing Institutional SMMPs could withdraw their SMMP status and obtain the

⁵⁷ See, e.g., Harry Gliksmán, 54 S.E.C. 471, 475 (1999) (upholding a NASD finding that a registered representative violated his suitability obligations by recommending frequent and short-term securities transactions even though the registered representative did not have written discretionary authority).

⁵⁸ See related discussion supra under Background and Purpose of the Institutional SMMP Amendment – Background on MSRB Rule D-15 and SMMP Affirmation Requirements. See also MSRB Rule D-15(c)(1)-(2).

suitability protections afforded by MSRB Rule G-19. This ability to self-identify as an Institutional SMMP will ensure that those institutional customers who desire additional investor protection can secure them under MSRB rules, and thus, require the dealers to undertake a quantitative suitability analysis.

Accordingly, the MSRB believes that the proposed Institutional SMMP Amendment would maintain essential safeguards for investor protection and, overall, not compromise investor protections inconsistent with Section 15B(b)(2)(C)⁵⁹ of the Act.

4. Self-Regulatory Organization’s Statement on Burden on Competition

Section 15B(b)(2)(C) of the Act⁶⁰ requires that MSRB rules not be designed to impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The MSRB considered the economic impact associated with the proposed rule change, including a comparison to reasonable alternative regulatory approaches, relative to the baseline.⁶¹ The MSRB believes the proposed rule changes would relieve a burden on competition and do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

I. Necessity of Rule Change

a. Best Interest Amendments

As previously mentioned, the retail municipal recommendations made by Bank Dealers currently are outside the scope of Regulation Best Interest,⁶² and the municipal securities activities of Bank Dealers continue to be subject to the existing investor protection obligations of MSRB rules, including MSRB Rule G-19. The proposed Best Interest Amendments to MSRB Rule G-19 would require each Bank Dealer to comply with the requirements of Regulation Best Interest to the same extent as a Broker-Dealer must. The proposed Best Interest Amendments are necessary because they would increase investor protection in the municipal securities market by creating regulatory uniformity in the market between the municipal securities activities of Bank

⁵⁹ 15 U.S.C. 78o-4(b)(2)(C).

⁶⁰ Id.

⁶¹ See Policy on the Use of Economic Analysis in MSRB Rulemaking, available at <http://msrb.org/Rules-and-Interpretations/Economic-Analysis-Policy.aspx>. In evaluating whether there was a burden on competition, the Board was guided by its principles that required the Board to consider costs and benefits of a rule change, its impact on capital formation and the main reasonable alternative regulatory approach.

⁶² Regulation Best Interest applies to “a broker, dealer or a natural person who is an associated person of a broker or dealer,” which does not apply Bank Dealers. See 17 CFR § 240.15l-1(a)(1).

Dealers and those of Broker-Dealers, each of whom may provide retail municipal recommendations. Similar to the Broker-Dealer Harmonization Filing for Broker-Dealers in 2020, the MSRB believes another benefit of the proposed Best Interest Amendments is that the amendments would reduce agency costs and information asymmetry between Bank Dealers and retail customers.⁶³

The MSRB addresses reasonable alternatives where applicable when considering the costs, benefits, and impact of a proposed amendment. The MSRB believes the only reasonable alternative for evaluation is the option of leaving in place the current regulatory state in which a Bank Dealer's retail municipal recommendations are not subject to the requirements of Regulation Best Interest, while a Broker-Dealer's retail municipal recommendations are subject to the full requirements of Regulation Best Interest, even though the activities of both groups of dealers are similar. As shown below, the MSRB believes that maintaining the status quo would preserve a regulatory imbalance and therefore competitive imbalance in this regard between Bank Dealers and Broker-Dealers engaged in the same activity, as well as deprive certain retail customers of the investor protections afforded by Regulation Best Interest. In this way, maintaining the status quo would maintain a discrepancy in the investor protections afforded to the retail customers receiving retail municipal recommendations from Bank Dealers as compared to the investor protections afforded to retail customers receiving retail municipal recommendations from Broker-Dealers and, thereby, maintain a competitive imbalance in terms of the compliance burdens of Bank Dealers versus Broker-Dealers.

b. Institutional SMMP Amendment

The purpose of amending MSRB Rule G-48 is to reinstate the requirement that a dealer have actual control or de facto control with respect to Institutional SMMP accounts to trigger a dealer's quantitative suitability obligation. A prior rule provision, applying the quantitative suitability obligation only when a dealer had actual control or de facto control over the account, was removed as part of the Broker-Dealer Harmonization Filing; and, as a result, dealers currently have an obligation to conduct a quantitative suitability analysis for transactions with Institutional SMMP customers whether or not the dealer has actual control or de facto control over the Institutional SMMP's account. The proposed Institutional SMMP Amendment to MSRB Rule G-48 will clarify that the quantitative suitability requirement of MSRB Rule G-19 is only applicable to natural person SMMPs but not to Institutional SMMPs. Since the proposed Institutional SMMP Amendment reinstates a previous requirement in the MSRB's suitability rule, the MSRB considered the alternative of placing the reinstated requirement in MSRB Rule G-19 for all institutional entities but decided that MSRB Rule G-48 is a more appropriate place to incorporate the reinstated standard, as Institutional SMMPs are by their nature sophisticated

⁶³ The SEC describes this reduction in agency cost, in the Regulation Best Interest Adopting Release, as "the difference between the net benefit to the retail customer from accepting a less than efficient recommendation about a securities transaction or investment strategy, where the associated person or Broker-Dealer puts its interests ahead of the interests of the retail customer, and the net benefit the retail customer might expect from a similar securities transaction or investment strategy that is efficient for him or her." See Regulation Best Interest Adopting Release, 84 FR at 33403.

entities that have freely affirmed and self-identified their capacity to independently evaluate dealers' recommendations.

II. Benefits, Costs and Effect on Competition

a. Best Interest Amendments

The proposed Best Interest Amendments to MSRB Rule G-19 would help create a uniform standard of investor protection for retail municipal recommendations. The proposed Best Interest Amendments to MSRB Rule G-19 would obligate a Bank Dealer to comply with Regulation Best Interest to the same extent as a Broker-Dealer making retail municipal recommendations. In this regard, the MSRB believes the effects of the proposed Best Interest Amendments would be similar and comparable to the effects resulting from when Broker-Dealers were first required to comply with Regulation Best Interest, though at a much smaller scale concerning only retail municipal recommendations.⁶⁴ Therefore, the MSRB believes that the SEC's estimates of the burdens on competition and benefits of applying Regulation Best Interest to Broker-Dealers is a reasonable reference point for analyzing burdens on competition and benefits of applying Regulation Best Interest to Bank Dealers' retail municipal recommendations. The MSRB therefore built upon the findings of the SEC's multiyear in-depth analysis for its analysis of the proposed Best Interest Amendments.

Notably, in the Regulation Best Interest Adopting Release, the SEC emphasized that it is "difficult to quantify such benefits and costs with meaningful precision" for Broker-Dealers and, particularly over long time periods, the quantification may be insufficiently precise and inherently speculative,⁶⁵ mainly due to the following factors, among others, (i) a lack of data on the extent to which Broker-Dealers with different business practices engage in disclosure and conflict mitigation activities to comply with existing requirements, and therefore how costly it would be to comply with the proposed requirements;⁶⁶ (ii) Regulation Best Interest provides Broker-Dealers flexibility in how to comply with the obligations and, as a result, there could be multiple ways in which Broker-Dealers will satisfy their obligations;⁶⁷ and (iii) Regulation Best Interest may affect Broker-Dealers differently depending on their business model (e.g., full-service Broker-Dealer, Broker-Dealer that uses independent contractors, insurance-affiliated Broker-Dealer) and size.⁶⁸

⁶⁴ See Regulation Best Interest Adopting Release, 84 FR at 33403.

⁶⁵ Id. The MSRB is not aware of any post-implementation study or other analysis that provides data on the costs and benefits of adopting Regulation Best Interest.

⁶⁶ See Regulation Best Interest Adopting Release, 84 FR at 33434.

⁶⁷ Id.

⁶⁸ Id.

The SEC further cautioned that the associated costs for each individual Broker-Dealer firm could not be anticipated because of the wide variation in size and scope of business practices across firms as well as the many unknown factors associated with the principles-based nature of the Regulation Best Interest.⁶⁹ The MSRB believes the same difficulties and complexities experienced by the SEC in attempting to analyze the economic effects of applying Regulation Best Interest to Broker-Dealers also applies to the MSRB's attempt to provide a meaningful quantitative estimate of the impact of the proposed Best Interest Amendments on Bank Dealers.⁷⁰

While acknowledging these challenges, the MSRB attempted to determine the scope of activity that would be subject to the proposed Best Interest Amendments, which is summarized in **Table 1** below. The summary table provides an estimate of the number of Bank Dealers likely to be affected by the proposed Best Interest Amendments. The Bank Dealers were included in that table based on their market share of retail-sized dealer-to-customer trades in calendar year 2020 (i.e., dealer-to-customer trades with a par value of \$100,000 or less).⁷¹ Among the over 1,200 dealers registered with the MSRB, only 21 firms are registered as Bank Dealers. Those 21 Bank Dealers conducted only 1.6% of all retail-sized dealer-to-customer trades in municipal securities in 2020.⁷² Even among the 21 Bank Dealers, nearly all of this activity was concentrated in a small number of firms, with the top seven most-active Bank Dealers conducting the vast majority of all retail-sized customer trades in 2020 (about 99.5%). The remaining number of registered Bank Dealers were significantly less active in executing retail-sized trades with customers during that same period, with six Bank Dealers not executing any

⁶⁹ Id.

⁷⁰ The MSRB sought public comment to solicit data to use in a quantitative analysis relating to the proposed changes in its Request for Comments. While commenters did provide some specifics on the scope of Bank Dealers' activities that would be subject to the proposed Best Interest Amendments, the MSRB did not receive any quantitative estimate of the impact of the proposed Best Interest Amendments on Bank Dealers. In addition, the MSRB is not aware of any post-implementation study that provides data on the costs and benefits of adopting Regulation Best Interest.

⁷¹ The MSRB does not have access to reliable data to determine the precise number of Bank Dealers who provide (or may provide) recommendations to investors who meet the definition of a retail customer. To develop a reasonable proxy, the MSRB analyzed market data to determine the number of retail-sized trades (par value at \$100,000 or less in this case). In the absence of more specific data about a trade, total par size of \$100,000 or less is commonly used in the municipal securities market as an indicator of a retail activity. Data were obtained from the MSRB's Real-Time Transaction Reporting System (RTRS) and the MSRB's registration database.

⁷² These figures are provided by an MSRB analysis with data obtained from MSRB's Real-Time Transaction Reporting System (RTRS) combined with existing registration data.

retail-sized customer trades over the course of the entire year and the remaining eight Bank Dealers altogether averaging a little over one retail-sized customer trade per day.

Table 1:
Market Share of Municipal Securities
Retail-Sized Customer Trades by Dealers
January 2020 – December 2020

Type of Dealers	Number of Retail-Sized Customer Trades	Market Share of Retail-Sized Customer Trades
Non-Bank Dealers	3,865,880	98.4%
Top Seven Bank Dealers	61,140	1.6%
All Fourteen Other Bank Dealers	325	0.0%

Source: MSRB analysis with data obtained from the MSRB’s Real-Time Transaction Reporting System (RTRS) and the MSRB’s registration database.

In developing these numbers, the MSRB believes they are likely overly inclusive of potential retail activity, because there is a high probability the numbers capture more trades than would be subject to the requirements of the proposed Best Interest Amendments. Nevertheless, the MSRB believes the numbers are a reasonable estimate for the purpose of this economic analysis and are conservative to the extent that they are more likely to over-estimate the potential burden on Bank Dealers than underestimate it. In terms of the limitations of this data, dealer-to-customer trades with a par value of \$100,000 or less are not always conducted with investors who would meet the definition of a retail customer under Regulation Best Interest, as representatives acting on behalf of non-retail customers potentially execute trades with a par value of \$100,000 or less (*i.e.*, small institutional trades). Conversely, retail investors may execute trades above \$100,000 par value (*i.e.*, large retail trades); however, the MSRB believes large retail trades occur less frequently and, thus, do not fully offset the more frequent occurrences of sub-\$100,000 par value non-retail trades.⁷³

Additionally, the MSRB acknowledges that the number of trades is not a reasonable proxy for the number of retail municipal recommendations. That is, the fact that a Bank Dealer executes a trade with an investor who meets the definition of a retail customer under Regulation Best Interest does not necessarily mean that the Bank Dealer has made a “recommendation” to

⁷³ For example, one commenter, the Capital Markets Group of Commerce Bank (“CMG”) based in Kansas City, MO, stated that “For CMG, retail customers comprise approximately 9% of CMG’s total open account customer base. Further, only a portion of these retail accounts actually executed transactions in the last 12 months, comprising approximately 3% of CMG’s total customers” See letter from Erik Swanson, Managing Director, and Joseph Reece, Chief Compliance Officer, Capital Markets Group of Commerce Bank (“Commerce Bank”), not dated (the “Commerce Bank Letter”) in response to MSRB Notice 2021-06 (March 4, 2021).

such retail customer for purposes of Regulation Best Interest. The Bank Dealer may have, for example, executed a non-recommended trade at the customer's request. Hence, the MSRB believes that some unknown number of these retail-sized trades would not be subject to the proposed Best Interest Amendments (i.e., the trades would not be subject to Regulation Best Interest).

i. Benefits

The MSRB believes extending the requirements of Regulation Best Interest to Bank Dealers would reduce or eliminate a regulatory imbalance between Bank Dealers, on the one hand, and Broker-Dealers, on the other, as the terms of Regulation Best Interest do not currently apply to Bank Dealers. The proposed Best Interest Amendments would both close a regulatory gap and also mitigate certain market risks and inefficiencies associated with a potentially lower compliance standard.⁷⁴ Therefore, the proposed Best Interest Amendments would protect retail customers seeking investment recommendations and transacting in municipal securities, regardless of whether they are customers of a Broker-Dealer or a Bank Dealer. The MSRB believes retail customers receiving retail municipal recommendations should benefit from a uniform standard of enhanced investor protections, which would not be dependent upon the type of dealer entity making the retail municipal recommendation.

As to the overall merit of the proposed new requirements, they are intended to reduce Bank-Dealer retail customer agency costs by lessening conflicts of interest that currently exist between Bank Dealers and retail customers and reduce information asymmetries limiting the ability of retail customers to assess the efficiency of recommendations from Bank Dealers.⁷⁵

ii. Costs

If the proposed Best Interest Amendments were enacted, the MSRB believes Bank Dealers would experience initial costs associated with establishing the revised policies and procedures to comply with the requirements of Regulation Best Interest, as well as the costs of ongoing compliance. The initial setup costs likely would be proportionately higher for smaller and less active Bank Dealers with fewer retail municipal recommendations than for the larger and more active Bank Dealers with more retail municipal recommendations, while the ongoing costs would likely be proportionate with each Bank Dealer's retail business activities. Additionally, Bank Dealers with an affiliated Broker-Dealer that is subject to Regulation Best Interest likely would not experience as much initial set-up costs as other Bank Dealers because

⁷⁴ As one potential example, where a Bank Dealer and a Broker-Dealer are both subsidiary entities of a common parent holding company, the MSRB is concerned that the parent holding company may attempt to take advantage of any regulatory imbalance by utilizing a regulatory arbitrage strategy to move retail customer accounts to the subsidiary with the lowest compliance standard, and, thus, Broker-Dealers may relocate retail customer accounts to affiliated Bank Dealers to avoid compliance with Regulation Best Interest.

⁷⁵ For a detailed discussion of the economic theory behind agency costs, please refer to the Regulation Best Interest Adopting Release, 84 FR at 33400-41.

they can leverage established policies and procedures from their Broker-Dealers affiliates presumably in compliance with Regulation Best Interest.

The MSRB believes the average per-firm total costs (initial and ongoing) would be substantially lower for a Bank Dealer providing retail municipal recommendations that are *only* related to municipal securities, as compared to the overall costs associated with a Broker-Dealer providing recommendations to retail customers of securities transactions or investment strategies involving securities related to many different types of securities. On average, there are many more retail-sized trades in other types of securities – for example, equities, corporate bonds, treasury and agency securities, options, convertible bonds, mutual funds, and exchange-traded funds – than in municipal securities alone.⁷⁶ A Broker-Dealer subject to Regulation Best Interest incurs compliance costs any time it provides a recommendation to its retail customers on any security, while a Bank Dealer would only incur cost when it provides a retail municipal recommendation. As a result, the MSRB believes the average per-Bank Dealer total costs would not approach the per-Broker-Dealer level, as estimated by the SEC in relation to Regulation Best Interest. **Table 2** provides an illustration of potential costs to be expected for a Bank Dealer with an average number of retail-sized trades in municipal securities as a result of the proposed rule change. Using the SEC’s estimates of initial cost and ongoing cost for 2,766 Broker-Dealers, the MSRB estimated the portion of the costs attributable to municipal securities only for a Broker-Dealer with an average number of retail-sized trades in municipal securities, with the assumption that the same Broker-Dealer would incur only 35% of the initial cost and one percent of the ongoing cost if the Broker-Dealer only provided recommendations on municipal securities to retail customers.⁷⁷ The MSRB then applied the cost estimates to an average Bank Dealer.

⁷⁶ Based on the MSRB’s estimate, there were approximately five million retail-sized customer trades in municipal securities in 2018, compared to 6.8 million retail-sized customer trades in corporate bonds, 132.5 million retail-sized customer trades in treasury securities and 4.4 billion retail-sized customer trades in equities, which include exchange-traded funds.

⁷⁷ The MSRB’s analysis focuses on four securities that have substantial retail customer trades: municipal securities, corporate bonds, treasury securities and equities, which include exchange-traded funds. To be conservative, all other securities, such as stock options, federal agency securities, mortgage-backed securities, asset-backed securities, mutual funds, etc., are assumed to have no retail trades. For the initial cost, the MSRB assumes a cost saving of 65% when establishing policies and procedures for one security only, municipal bonds, as opposed to for four securities, accounting for some fixed costs when working on a single security product. For the ongoing cost, the MSRB estimated the number of retail-sized customer trades for municipal securities that are likely based on a Broker-Dealer’s recommendation relative to comparable retail-sized customer trades for corporate bonds, treasury securities and equities (including exchange-traded funds), and derived that the proportion for municipal securities would be less than one percent of the total. Conservatively, one percent is used for estimating the ongoing costs related to municipal securities. Data were obtained from the MSRB’s Real-Time Transaction Reporting System (RTRS), MSRB’s registration database, and SEC’s estimates of costs and benefits of applying Regulation Best Interest to Broker-Dealers.

Table 2:
Estimated Initial Setup and Ongoing Compliance Costs for an Average Bank Dealer

	Initial Cost	Ongoing Cost	Number of Retail-Sized Customer Trades
SEC Estimate			
Average Broker-Dealer (Non-Bank Dealer)	\$ 2,153,290	\$ 855,897	
Average Broker-Dealer Trading Municipal Bonds Only	\$ 753,651	\$ 8,559	5,523
Apply SEC Estimate to Average Bank Dealer Trading Municipal Bonds	\$ 753,651	\$ 4,590	2,962

Source: MSRB analysis with data obtained from the MSRB's Real-Time Transaction Reporting System (RTRS), MSRB's registration data and SEC's estimates of costs and benefits of applying Regulation Best Interest to Broker-Dealers.⁷⁸

iii. Effect on Competition, Efficiency, and Capital Formation⁷⁹

The MSRB believes that, if the proposed Best Interest Amendments were adopted, there is a possibility some Bank Dealers that rarely execute retail-sized customer trades, assuming those trades represent retail municipal recommendations, may choose to forgo retail business entirely to avoid the costs of compliance with proposed Best Interest Amendments and Regulation Best Interest, or more narrowly, stop providing retail municipal recommendations to limit the costs of compliance. Therefore, some Bank Dealers may be impacted by the proposed Regulation Best Interest Amendments by deciding to forego retail municipal recommendations or retail customer business altogether, though the broader impact on competition in the municipal securities market is expected to be minor given these Bank Dealers' relatively minor presence in executing retail-sized trades for municipal securities currently; accordingly, even if those Bank Dealers choose to relinquish their retail business, there should not be any significant reduction in the supply of services to retail investors. On the other hand, the MSRB does not expect a significant alteration to the competitive landscape from retail investors' perspective if the proposed Best Interest Amendments were adopted, as retail investors rarely use Bank Dealers for retail trading. Moreover, for those retail investors who do choose Bank Dealers to conduct retail activities, their activities are concentrated in a small number of Bank Dealers who are less likely to withdraw from the retail business as a result of the burdens created by the proposed Best Interest Amendments.

⁷⁸ See Regulation Best Interest Adopting Release, 84 FR at 33318.

⁷⁹ Capital formation is defined by the SEC on their website "What we do," available at <https://www.sec.gov/about/what-we-do#section2>. It refers to companies and entrepreneurs accessing America's capital markets to help them create jobs, develop innovations and technology, and provide financial opportunities for those who invest in them. *Id.*

The MSRB believes requiring Bank Dealers to comply with the requirements of Regulation Best Interest, when making retail municipal recommendations, would improve market efficiency by imposing the same requirements on Bank Dealers when making such recommendations as on Broker-Dealers under Regulation Best Interest. The harmonization of MSRB rule requirements for Bank Dealers with SEC requirements for Broker-Dealers would create consistency for firms who have both Broker-Dealer and Bank Dealer subsidiaries, and, thus, would increase efficiency in terms of firms' compliance burdens. It also may encourage competition for retail customers among Bank Dealers (and between Bank Dealers and Broker-Dealers in some instances) to the extent that the disclosure of fees and conflicts of interest would increase transparency and facilitate more comparability across Bank Dealers and Broker-Dealers among retail investors, and, therefore, would further inform customers' decisions of whether to utilize a Bank Dealer versus a Broker-Dealer for transactions in municipal securities. In addition, the MSRB believes investors should benefit from receiving the same type of information from Bank Dealers and Broker-Dealers in relation to an investment recommendation. Therefore, as stated above, because of the creation of consistent regulatory requirements across Bank Dealers and Broker-Dealers for their retail municipal recommendations and the greater competition fostered by this consistency among firms serving retail customers, the MSRB believes that the proposed Best Interest Amendments would facilitate capital formation.

b. Institutional SMMP Amendment

The MSRB proposal to amend MSRB Rule G-48 would reinstate a previously existing actual control or de facto control standard for Institutional SMMP accounts for purposes of dealers' quantitative suitability obligations.

i. Benefits

The proposed Institutional SMMP Amendment to MSRB Rule G-48 would reduce the compliance burden for all dealers, including Bank Dealers and Broker-Dealers, by eliminating the requirements to undertake a quantitative suitability analysis for Institutional SMMPs when a dealer does not have actual control or de facto control over the customer's accounts. The requirement is not necessary because of the sophistication and differing needs of Institutional SMMPs who have knowingly declined to have such requirements apply to them, as described herein.

ii. Costs

The MSRB believes the proposed Institutional SMMP Amendment to MSRB Rule G-48 to modify the quantitative suitability obligation of a dealer in the limited circumstances provided under the proposed Institutional SMMP Amendment would have minimal costs associated, particularly since the intent was to reinstate an exemption from quantitative suitability previously enacted for all recommendations through MSRB Rule G-19. One potential one-time cost would be for all dealers, including Bank Dealers and Broker-Dealers, to update their policies and procedures. Because of the recent existence of the same actual control or de facto control standard that would be reestablished by the proposed Institutional SMMP Amendment, the MSRB believes this one-time change should be familiar to firms and the cost of compliance implementation will be reduced in this regard. Moreover, to the degree that dealers are likely to

reintroduce the same standards in their policies and procedures as previously existed, the cost of implementation would be minimized.

In addition, one impetus of the Broker-Dealer Harmonization Filing was to harmonize the rule with Regulation Best Interest and FINRA Rule 2111 and to reduce inconsistency on suitability requirements between FINRA's rules and MSRB's rules. By amending MSRB Rule G-48 to provide a narrow exemption from the application of quantitative suitability, this rule would not be fully harmonized with FINRA Rule 2111, and, thus, would establish two standards for accounts across the corporate and municipal securities markets. The MSRB believes that this lack of harmonization is justified in this instance for all the reasons stated herein,⁸⁰ including the fact that Institutional SMMPs are by their nature sophisticated entities that have affirmed and self-identified their capacity to independently evaluate dealers' recommendations of municipal securities transactions.

iii. Effect on Competition, Efficiency, and Capital Formation

The MSRB believes the proposed Institutional SMMP Amendment to MSRB Rule G-48 would improve the operational efficiency of the municipal securities market by reintroducing the element of actual control or de facto control with respect to Institutional SMMP accounts that would trigger a dealer's quantitative suitability obligation, as dealers would have one fewer compliance burden. The MSRB does not expect that the proposed Institutional SMMP Amendment to MSRB Rule G-48 would harm competition in the municipal securities market, because the proposed Institutional SMMP Amendment would be applicable to all dealers and, therefore, any of the benefits and burdens created by the proposed Institutional SMMP Amendments would be evenly applied to all such firms transacting with Institutional SMMP customers and, thereby, avoid discriminatory impacts among dealer firms.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

On March 4, 2021, the Board published a request for comment seeking public feedback on requiring Bank Dealers to comply with Regulation Best Interest when making a retail municipal recommendation (the "Request for Comments").⁸¹ The Board received five comments letters in response to the Request for Comments.⁸² Each of these will be addressed below. The

⁸⁰ See related discussion supra under Purpose and Intent of the Institutional SMMP Amendment to MSRB Rule G-48.

⁸¹ MSRB Notice 2021-06 (March 4, 2021).

⁸² Letter from Justin M. Underwood, Executive Director, American Bankers Association ("Bankers Association"), dated June 2, 2021 (the "Bankers Association Letter"); Letter from Christopher A. Iacovella, Chief Executive Officer, American Securities Association ("Securities Association"), dated May 27, 2021 (the "Securities Association Letter"); the Commerce Bank Letter; Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association

comment letters addressing the proposed Best Interest Amendments will be discussed separately from the one comment letter addressing the proposed Institutional SMMP Amendment.

I. Discussion of Comments Related to the Best Interest Amendments

The MSRB received four comment letters addressing the proposed Best Interest Amendments in response to its Request for Comments. Comments submitted by SIFMA and the Securities Association were supportive of the proposed Best Interest Amendments, while the comments submitted by the Bankers Association and Commerce Bank expressed concerns about the proposed Best Interest Amendments, generally, in terms of the consequences of the potential compliance burden in relation to Bank Dealers' limited retail customer activity, as further discussed below.

A. Support for a Uniform Regulatory Standard

SIFMA cited the goal of achieving regulatory parity among regulated entities as the reason for being in favor of the proposed rule change.⁸³ Specifically, the SIFMA Bank Dealer Letter stated that "SIFMA supports the proposed amendment to extend Regulation Best Interest to bank dealers, as defined in the notice" and that "we believe that regulatory parity among regulated entities, which this amendment achieves, is a worthwhile goal."⁸⁴ The Securities Association cited a reduction in regulatory confusion and establishing Regulation Best Interest as the standard for Broker-Dealers and Bank Dealers as the reasons for being in favor of the proposed rule change.⁸⁵ The Securities Association stated that adopting Regulation Best Interest for bank dealers will "reduce regulatory confusion for municipal dealers and further establish [Regulation Best Interest] as the national standard for broker-dealers and bank dealers."⁸⁶ Further, the Securities Association stated that "[it] appreciates the work by the MSRB in the Proposal to align their rules with the SEC and Financial Industry Regulatory Authority's (FINRA) when possible so that broker-dealers are not subjected to multiple standards."⁸⁷ As discussed above, the Board agrees with the commenters that the proposed Best Interest Amendments would benefit the municipal securities market through more uniform regulatory standards.

("SIFMA"), dated June 2, 2021 (the "SIFMA Bank Dealer Letter"); and Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, SIFMA, dated June 2, 2021 (the "SIFMA SMMP Letter").

⁸³ SIFMA Bank Dealer Letter at 2.

⁸⁴ SIFMA Bank Dealer Letter at 1-2.

⁸⁵ Securities Association Letter at 1.

⁸⁶ Id. at 1.

⁸⁷ Id. at 2.

B. Concerns Regarding Bank Dealer’s Compliance Burden and Effects on Competition

Among other topics in the Request for Comments, the Board sought public input on the potential burdens associated with the proposed Best Interest Amendments and, in particular, if requiring Bank Dealers to comply with Regulation Best Interest would disincentivize Bank Dealers from engaging in certain municipal securities activities with retail customers.⁸⁸ Commerce Bank and the Bankers Association offered comments. The Bankers Association commented that, while its members have long supported the notion that financial professionals offering investment advice to retail customers should be subject to a best interest standard, the Bankers Association urged the Board to consider the compliance costs imposed by such a rule on Bank Dealers in relation to their limited amount of retail customer activity.⁸⁹ The Bankers Association continued, stating that, ultimately, Bank Dealers in municipal securities do not have a significant retail customer base to warrant a new regulatory compliance regime in this manner.⁹⁰

Echoing this concern regarding the potential compliance burden of the proposed Best Interest Amendments, Commerce Bank responded that they would assess the additional compliance costs that come with compliance with Regulation Best Interest and consider the elimination of providing recommendations for securities or strategies to retail customers.⁹¹ Commerce Bank also expressed concern that the compliance burden of the proposed Best Interest Amendments may cause it to eliminate or become uncompetitive in relation to certain underwriting activities, particularly for services provided to issuers utilizing retail order periods.⁹²

⁸⁸ Request for Comments at 7.

⁸⁹ Bankers Association Letter at 2

⁹⁰ Id.

⁹¹ Commerce Bank Letter at 2.

⁹² Commerce Bank Letter at 3 (“Assuming the amendments are approved as adopted and bank dealers begin to move away from providing services to retail customers, bank dealers that underwrite municipal bonds would need controls in place to ensure underwriting or related commitments are appropriate for any retail order periods required by an issuer. The potential impact may be a smaller number of underwriting firms available or willing to work with smaller issuers and public entities in the market, limiting the number of competitors available for either competitive or negotiated deals.”) In addition to the reasons discussed below, the MSRB observes that analogous concerns regarding such dampening effects of Regulation Best Interest’s requirements on the competition for underwriting activities equally apply to Broker-Dealers. Yet, the Commission ultimately found that Regulation Best Interest would not have a deleterious effect on capital formation. See, generally, Regulation Best Interest Adopting Release, 84 FR at 33461 et seq.

While the Board believes that commenters' concerns regarding the potential compliance burden for Bank Dealers associated with the proposed Best Interest Amendments are valid, the Board also believes that the potential investor protection benefits associated with the proposed Best Interest Amendments outweigh these potential compliance burdens for Bank Dealers. The Bankers Association Letter and the Commerce Bank Letter articulated concerns regarding the potential compliance burden associated with the proposed Best Interest Amendments,⁹³ but these commenters did not specifically address why Bank Dealers face compliance burdens that are materially different from those faced by Broker-Dealers, who are already required to adhere to the enhanced suitability standards required by Regulation Best Interest. Consequently, the MSRB is unaware of any material distinctions between the municipal securities activities of Bank Dealers and Broker-Dealers that would persuade the MSRB to propose a non-uniform regulatory scheme of lesser investor protections for the retail municipal recommendations of Bank Dealers.

Moreover, in developing the proposed Best Interest Amendments, the MSRB observed that Regulation Best Interest did not adopt de minimis thresholds or other standards to exclude smaller regulated entities with lesser amounts of retail customer activity from Regulation Best Interest's baseline compliance burdens.⁹⁴ Relatedly, the Commission concluded that the final version of its Regulation Best Interest appropriately balanced the concerns of various commenters from larger and smaller entities.⁹⁵ Similar to the Commission's determination, the MSRB believes that the proposed Best Interest Amendments are written to balance the interests of commenters, including the various types and sizes of dealer entities, to best achieve the important goals of enhancing retail investor protection and decision making, while preserving, to the extent possible, retail investor access (in terms of choice and cost) to differing types of municipal security investment services and municipal security products.

Relatedly, the MSRB observes that the Commission determined that Regulation Best Interest would not have a deleterious effect on capital formation.⁹⁶ More specifically, the

⁹³ See, respectively, Bankers Association Letter at 2 and Commerce Bank Letter at 2 (noting that retail accounts account for approximately 9% of their total open accounts and only a portion of these accounts transacted in the previous twelve months).

⁹⁴ See, generally, Regulation Best Interest Adopting Release, 84 FR at 33485 et seq (discussing impact on "Small Entities Subject to the Rule").

⁹⁵ Regulation Best Interest Adopting Release, 84 FR at 33323 ("After careful consideration of the comments and additional information we have received, we believe that Regulation Best Interest, as modified, appropriately balances the concerns of the various commenters in a way that will best achieve the Commission's important goals of enhancing retail investor protection and decision making, while preserving, to the extent possible, retail investor access (in terms of choice and cost) to differing types of investment services and products.")

⁹⁶ See, generally, Regulation Best Interest Adopting Release, 84 FR at 33461 et seq.

Commission concluded that (i) the possibility that Regulation Best Interest may increase the efficiency of the recommendations provided by the associated persons of the broker-dealer may enhance the attractiveness of broker-dealer services for those investors who currently do not invest through broker-dealers,⁹⁷ and (ii) if retail customers are more willing to participate in the securities markets through broker-dealers, Regulation Best Interest would have a positive effect on capital formation.⁹⁸

For similar reasons, the MSRB believes that the proposed Best Interest Amendments would not hinder capital formation in the municipal securities market, as suggested by the Commerce Bank Letter, such as in instances where there is less underwriter competition for small municipal issuers or municipal issuers who seek to utilize retail order periods. To the degree that retail municipal recommendations are subject to a uniform regulatory standard across Bank Dealers and Broker-Dealers, the MSRB believes that the proposed Best Interest Amendments may increase the efficiency of retail municipal recommendations and enhance the attractiveness of dealer's municipal security services. This uniform regulatory standard could draw more retail customers to the primary offering of municipal securities with retail order periods and, in this respect, incrementally reduce issuer borrowing costs.

II. Discussion of Comments Related to the Institutional SMMP Amendment

The Board did not seek separate comment on the proposed Institutional SMMP Amendment but did receive the SIFMA SMMP Letter as part of the Request for Comments, which was generally supportive of the proposed Institutional SMMP Amendment. SIFMA stated in the SMMP Letter that its members “feel strongly that the Quantitative Suitability Requirement in Rule G-19 should be clarified, and interpreted as applicable only to natural person SMMPs, but not to institutional SMMPs. Extending the Quantitative Suitability Requirement to all SMMPs would be unduly costly and burdensome.”⁹⁹ As discussed above, the Board agrees with the commenter that requiring a dealer to undertake a quantitative suitability analysis, when an institutional customer has already affirmatively opted out of receiving such an analysis, is an unnecessarily burdensome requirement to place on dealer's recommendations to Institutional SMMPs.

SIFMA cited the MSRB's “history of treating SMMPs differently from non-SMMPs, based on a reasoned recognition of the differences between these two investor classes and the relative protections that should be afforded to both.”¹⁰⁰ The Board agrees that in limited circumstances it is appropriate for certain investor classes to be afforded different protections under MSRB rules, as different classes can have differing levels of sophistication, differing risk

⁹⁷ Regulation Best Interest Adopting Release, 84 FR at 33462.

⁹⁸ Id.

⁹⁹ SIFMA SMMP Letter at 2.

¹⁰⁰ SIFMA SMMP Letter at 3.

tolerances, and differing investment goals. As noted above, the SMMP concept and the modified regulatory obligations afforded to SMMPs under MSRB rules are intended to account for the distinct capabilities of certain self-identifying, sophisticated, non-retail customers, as well as the varied types of dealer-customer relationships occurring in the municipal securities markets. Thus, the MSRB believes it is appropriate to afford Institutional SMMPS more finely tailored protections, and that the proposed Institutional SMMP Amendment would not erode the overall protections afforded to Institutional SMMPs.

6. Extension of Time Period for Commission Action

The MSRB does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.¹⁰¹

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notice Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervisions Act

Not applicable.

11. Exhibits

Exhibit 1 Completed Notice of Proposed Rule Change for Publication in the Federal Register

Exhibit 2a MSRB Notice 2021-06 (March 4, 2021)

Exhibit 2b List of Comment Letters Received in Response to MSRB Notice 2021-06

Exhibit 2c Comment Letters Received in Response to MSRB Notice 2021-06

Exhibit 5 Text of Proposed Rule Change

¹⁰¹ 15.U.S.C. 78o-4(b)(2).

SECURITIES AND EXCHANGE COMMISSION
 (Release No. 34-_____ ; File No. SR-MSRB-2022-02)

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of a Proposed Rule Change Consisting of Amendments to MSRB Rule G-19 Regarding Regulation Best Interest for Certain Municipal Securities Activities of Bank Dealers and MSRB Rule G-48 Regarding Quantitative Suitability for Institutional Sophisticated Municipal Market Professionals

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on _____ the Municipal Securities Rulemaking Board (“MSRB” or “Board”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the MSRB. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The MSRB filed with the Commission a proposed rule change consisting of amendments to: (i) MSRB Rule G-19, on suitability of recommendations and transactions, and (ii) MSRB Rule G-48, on transactions with sophisticated municipal market professionals (“SMMPs”)³ (collectively, the “proposed rule change”). The proposed rule change would align MSRB Rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Under MSRB Rule D-15, on the term sophisticated municipal market professional, “[t]he term ‘sophisticated municipal market professional’ or ‘SMMP’ is generally defined by three essential requirements: the nature of the customer; a determination of sophistication by the broker, dealer or municipal securities dealer []; and an affirmation by the customer; as specified [therein].” See MSRB Rule D-15. See also related discussion under Background and Purpose of the Institutional SMMP Amendment - Background on MSRB Rule D-15 and SMMP Affirmation Requirements near note 37 infra.

G-19 to the Commission’s Rule 15l-1 under the Exchange Act (“Regulation Best Interest”)⁴ for certain municipal securities activities of bank dealers⁵ (the “Best Interest Amendments”). In addition, the proposed rule change would amend MSRB Rule G-48 to modify the quantitative suitability obligation of brokers, dealers, and municipal securities dealers (collectively, “dealers” and, individually, each a “dealer”) by eliminating the quantitative suitability obligation for recommendations in circumstances where a dealer does not have actual control or de facto control over the account of an Institutional SMMP (the “Institutional SMMP Amendment”).⁶

Subject to Commission approval, the respective compliance dates for the amendments to MSRB rules included in the proposed rule change will be announced in a regulatory notice published by the MSRB on its website within 30 days of the publication of the Commission’s approval order in the Federal Register. Such compliance date for the Best Interest Amendments will be no earlier than one year from the MSRB’s publication of the regulatory notice

⁴ 17 CFR § 240.15l-1; see also Exchange Act Release No. 86031 (June 5, 2019), 84 FR 33318 (July 12, 2019) (File No. S7-07-18) (“Regulation Best Interest Adopting Release”).

⁵ Consistent with MSRB Rule D-8, on the term bank dealer, the term “bank dealer” as used herein means “a municipal securities dealer which is a bank or a separately identifiable department or division of a bank as defined in rule G-1 of the Board.” Such references in this proposed rule shall be collectively to “Bank Dealers” or individually to a “Bank Dealer.” See also MSRB Rule D-11, on the term associated persons (indicating that the term bank dealer as used in MSRB rules shall generally refer to the associated persons of a bank dealer unless the context otherwise requires or a rule of the Board otherwise specifically provides).

⁶ The term “Institutional SMMP” is used here as defined below under the discussion Background and Purpose of the Institutional SMMP Amendment. The Institutional SMMP definition used herein would not encompass any natural person customers who qualify as “retail customers” under the definitions of Regulation Best Interest, such as certain natural persons with significant total assets, who might otherwise meet the status requirements of an SMMP. See note 20 infra and related discussion under Background and Purpose of the Institutional SMMP Amendment.

announcing it.⁷ Such compliance date for the Institutional SMMP Amendment will be no earlier than 30 days from the MSRB's publication of the regulatory notice announcing it.

The text of the proposed rule change is available on the MSRB's website at www.msrb.org/Rules-and-Interpretations/SEC-Filings/2022-Filings.aspx, at the MSRB's principal office, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the MSRB included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The MSRB has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The proposed rule change consists of the Best Interest Amendments to MSRB Rule G-19 and the proposed Institutional SMMP Amendment to MSRB Rule G-48 for the respective purposes further described below.

Background and Purpose of the Best Interest Amendments

The proposed Best Interest Amendments would amend MSRB Rule G-19 to extend the obligations of Regulation Best Interest to Bank Dealers when making recommendations to retail

⁷ This one-year minimum timeframe is roughly equivalent to the timeframe provided by the Commission when it adopted Regulation Best Interest. See Regulation Best Interest Adopting Release, 84 FR at 33318, 33400 (setting an effective date of September 10, 2019 and a compliance date of June 30, 2020).

customers of municipal securities transactions or investment strategies involving municipal securities (collectively, “retail municipal recommendations” and, individually, each a “retail municipal recommendation”). The Best Interest Amendments are intended to improve investor protection in the municipal securities market by ensuring that retail customers are afforded investor protections under Regulation Best Interest, regardless of whether a retail municipal recommendation received by a retail customer is made by a Broker-Dealer or a Bank Dealer.⁸

Background on the Commission’s Regulation Best Interest

On June 5, 2019, the SEC adopted Regulation Best Interest, which established a new standard of conduct for broker-dealers, and the natural persons who are associated persons of such broker-dealers (collectively, “Broker-Dealers” and, individually, each a “Broker-Dealer”), when making a recommendation to a retail customer of any securities transaction or investment strategy involving securities.⁹ As defined in Regulation Best Interest, the term “retail customer” generally refers to any natural person, or the legal representative of such person, who receives and uses a recommendation from a Broker-Dealer primarily for personal, family, or household

⁸ The term “Broker-Dealer” is used here as defined below under the following discussion Background on the Commission’s Regulation Best Interest.

⁹ See, generally, Regulation Best Interest Adopting Release (citation at note 4 *supra*). In response, on May 1, 2020, the MSRB filed a proposed rule change with the Commission to harmonize Regulation Best Interest with certain MSRB rules applicable to related municipal securities activities of Broker-Dealers. See Exchange Act Release No. 88828 (May 6, 2020), 85 FR 28082, File No. SR-MSRB-2020-02 (hereinafter, the “Broker-Dealer Harmonization Filing”), available at <https://msrb.org/-/media/Files/SEC-Filings/2020/MSRB-2020-02-Notice.ashx>?. The Commission approved these proposed amendments on June 25, 2020. See Exchange Act Release No. 89154 (June 25, 2020), 85 FR 39613 (July 1, 2020), File No. SR-MSRB-2020-02, available at <https://msrb.org/-/media/Files/SEC-Filings/2020/MSRB-2020-02-Federal-Register.ashx>?

purposes.¹⁰ Regulation Best Interest enhanced the Broker-Dealer standard of conduct beyond existing suitability obligations, such as those required by MSRB Rule G-19, on suitability, for such retail customers and aligned the applicable standard of conduct with the reasonable expectations of retail customers.¹¹ In this regard, Regulation Best Interest imposes the following “general obligation” on Broker-Dealers, stating a broker, dealer, or a natural person who is an associated person of a broker or dealer, when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer, shall act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.¹²

¹⁰ 17 CFR § 240.151-1(b)(1) (“Retail customer means a natural person, or the legal representative of such natural person, who (i) [r]eceives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and (ii) [u]ses the recommendation primarily for personal, family, or household purposes.”) For discussion of what it means for a retail customer to “use” a recommendation, see the SEC staff’s Frequently Asked Questions on Regulation Best Interest, available at <https://www.sec.gov/tm/faq-regulation-best-interest>.

¹¹ Regulation Best Interest Adopting Release, 84 FR at 33319.

¹² 17 CFR § 240.151-1(a)(1). Regulation Best Interest provides that this general obligation is satisfied only if a Broker-Dealer complies with four component obligations: (i) an obligation to make certain prescribed disclosures, before or at the time of the recommendation, about the recommendation and the relationship between the retail customer and the Broker-Dealer (the “Disclosure Obligation”) (see 17 CFR § 240.151-1(a)(2)(i)); (ii) an obligation to exercise reasonable diligence, care, and skill in making a recommendation (the “Care Obligation”) (see 17 CFR § 240.151-1(a)(2)(ii)); (iii) an obligation to establish, maintain, and enforce written policies and procedures reasonably designed to address conflicts of interest (the “Conflict-of-Interest Obligation”) (see 17 CFR § 240.151-1(a)(2)(iii)); and (iv) an obligation to establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with

Discussion of Regulation Best Interest's Current Applicability to Bank Dealers

By its terms, Regulation Best Interest does not apply to retail municipal recommendations made by Bank Dealers, because Bank Dealers in exempted securities have an exception from Broker-Dealer status under the Act and Regulation Best Interest applies only to Broker-Dealers. As a result, Bank Dealers presently are not required to comply with Regulation Best Interest and, therefore, retail investors may not benefit from its enhanced standard of conduct when receiving recommendations from Bank Dealers.¹³

Application of Regulation Best Interest to Bank Dealers

The proposed Best Interest Amendments would amend MSRB Rule G-19 to require a Bank Dealer to comply with Regulation Best Interest to the same extent as if it were a Broker-Dealer when making a retail municipal recommendation. Consequently, a Bank Dealer would have to act in the best interest of the retail customer at the time a retail municipal recommendation is made, without placing the financial or other interests of the Bank Dealer ahead of the interest of the retail customer. Correspondingly, the Bank Dealer would have to comply with the Commission's component obligations of Regulation Best Interest to the same extent as if it were a Broker-Dealer, including Regulation Best Interest's Disclosure

Regulation Best Interest (the "Compliance Obligation") (see 17 CFR § 240.151-1(a)(2)(iv)).

¹³ See Broker-Dealer Harmonization Filing, 85 FR at 28083, n. 5 (discussing how Bank Dealers are not subject to Regulation Best Interest by the terms of the SEC's rules and indicating the Board's intent to issue a request for comment regarding extending the requirements of Regulation Best Interest to Bank Dealers). Notably, all Bank Dealer recommendations, including retail municipal recommendations, are presently subject to the longstanding suitability obligations provided by MSRB rules, including MSRB Rule G-19 and, when applicable, MSRB Rule G-48.

Obligation,¹⁴ Care Obligation,¹⁵ Conflict-of-Interest Obligation,¹⁶ and Compliance Obligation.¹⁷

Under the proposed Best Interest Amendments, the component obligations of Regulation Best Interest would apply to those municipal securities activities associated with a retail municipal recommendation within the overall context of a Bank Dealer business model. The MSRB believes that any SEC guidance with respect to the understanding and application of Regulation Best Interest would be equally applicable to Bank Dealers.

Application of the Disclosure Obligation to Bank Dealers

Consistent with Regulation Best Interest's Disclosure Obligation, the proposed Best Interest Amendments would require a Bank Dealer, prior to or at the time of the retail municipal recommendation, to provide to its retail customer, in writing, full and fair disclosure of: (a) All material facts relating to the scope and terms of the relationship with the retail customer, including: (i) That the Bank Dealer is acting as a municipal securities dealer with respect to the retail municipal recommendation; (ii) The material fees and costs that apply to the retail customer's transactions, holdings, and accounts; and (iii) The type and scope of services provided to the retail customer, including any material limitations on the securities or investment strategies involving securities that may be recommended to the retail customer;¹⁸ and (b) All

¹⁴ 17 CFR § 240.151-1(a)(2)(i).

¹⁵ 17 CFR § 240.151-1(a)(2)(ii).

¹⁶ 17 CFR § 240.151-1(a)(2)(iii).

¹⁷ 17 CFR § 240.151-1(a)(2)(iv).

¹⁸ For example, if the applicable legal charter of a Bank Dealer only permits a Bank Dealer to conduct municipal securities activities or, in fact, a Bank Dealer's business model is limited to municipal securities activities, then the Bank Dealer generally would be required to accurately disclose the fact that it only engages in transactions involving municipal securities and, therefore, will only make recommendations to a retail customer

material facts relating to conflicts of interest that are associated with the retail municipal recommendation.

Application of the Care Obligation to Bank Dealers

Consistent with Regulation Best Interest's Care Obligation, the proposed Best Interest Amendments would require a Bank Dealer to exercise reasonable diligence, care, and skill to: (a) Understand the potential risks, rewards, and costs associated with any retail municipal recommendation, and have a reasonable basis to believe that a retail municipal recommendation could be in the best interest of at least some retail customers; (b) Have a reasonable basis to believe that the retail municipal recommendation is in the best interest of a particular retail customer, based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation, and does not place the financial or other interest of the Bank Dealer ahead of the interest of the retail customer; (c) Have a reasonable basis to believe that a series of retail municipal recommendations, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile and does not place the financial or other interest of the Bank Dealer ahead of the interest of the retail customer.

Application of the Conflict-of-Interest Obligation to Bank Dealers

Consistent with Regulation Best Interest's Conflict-of-Interest Obligation, the proposed Best Interest Amendments would require a Bank Dealer to establish, maintain, and enforce written policies and procedures reasonably designed to: (a) Identify and at a minimum disclose,

regarding transactions involving municipal securities. See also note 19 infra (discussing the Compliance Obligation pursuant to the Best Interest Amendments for Bank Dealers who do not engage in any retail municipal recommendations).

in accordance with its Disclosure Obligation, or eliminate, all conflicts of interest associated with such retail municipal recommendations; (b) Identify and mitigate any conflicts of interest associated with such retail municipal recommendations that create an incentive for a natural person who is an associated person of the Bank Dealer to place the interests of the Bank Dealer or such associated person ahead of the interest of the retail customer; (c)(i) Identify and disclose any material limitations placed on the securities or investment strategies involving securities that may be recommended to a retail customer and any conflicts of interest associated with such limitations, in accordance with its Disclosure Obligation, and (ii) Prevent such limitations and associated conflicts of interest from causing the Bank Dealer to make retail municipal recommendations that place the interest of the Bank Dealer ahead of the interest of the retail customer; and (d) Identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific municipal securities or specific types of municipal securities within a limited period of time.

Application of the Compliance Obligation to Bank Dealers

Consistent with Regulation Best Interest's Compliance Obligation, the proposed Best Interest Amendments would require a Bank Dealer to establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest.¹⁹

¹⁹ If a Bank Dealer's business model is such that it and its associated persons are not permitted to make any retail municipal recommendations, then a Bank Dealer may opt not to establish policies and procedures outlining the affirmative regulatory obligations pursuant to the Disclosure Obligation, Care Obligation, and Conflict of Interest Obligation. However, it would be prudent for a Bank Dealer to have policies and procedures that make clear that, prior to permitting the making of any such retail municipal recommendations, the Bank Dealer would need to establish policies and procedures reasonably designed to ensure compliance with the Best Interest Amendments to MSRB Rule G-19.

Purpose and Intent of the Best Interest Amendments

The MSRB is proposing the Best Interest Amendments to MSRB Rule G-19 for purposes of enhancing the standard of investor protection in the municipal securities market and enhancing fairness and efficiency in the municipal securities market by promoting regulatory parity among Bank Dealers and Broker-Dealers. Specific to enhancing the standard of investor protection, the MSRB believes that all retail customers receiving a retail municipal recommendation should benefit from the enhanced investor protections afforded by Regulation Best Interest, regardless of whether such a retail customer is a customer of a Broker-Dealer or a Bank Dealer. Currently, retail customers of Bank Dealers are not afforded the protections of Regulation Best Interest when receiving a retail municipal recommendation from a Bank Dealer. The proposed Best Interest Amendments would require a Bank Dealer to comply with the enhanced standard of conduct required by Regulation Best Interest and, thereby, improve overall investor protection in the municipal securities market.

Specific to promoting regulatory parity, the MSRB believes that the proposed Best Interest Amendments would establish a uniform regulatory standard in the municipal securities market by requiring the same standard of conduct for Bank Dealers and Broker-Dealers when making retail municipal recommendations. This uniform standard would enhance the fairness and efficiency of the municipal securities market by ensuring Bank Dealers have regulatory obligations and burdens when engaging in retail municipal recommendations that are equivalent to the regulatory obligations and burdens of Broker-Dealers when engaging in the same municipal securities activities. This uniformity would better ensure that Bank Dealers do not have a competitive advantage in the municipal securities market by operation of a less

burdensome regulatory standard of conduct and, thereby, mitigate the potential for regulatory arbitrage.

Background and Purpose of the Institutional SMMP Amendment

The proposed Institutional SMMP Amendment would amend MSRB Rule G-48 to modify the current obligation to perform a quantitative suitability analysis for recommendations where the dealer does not have actual control or de facto control over the account of an SMMP who is not a retail customer under Regulation Best Interest (collectively, “Institutional SMMPs” and, individually, each an “Institutional SMMP”).²⁰

Similar to the reduced customer-specific suitability obligations currently afforded to Institutional SMMPs under MSRB Rule G-48(c), the MSRB believes that dealers transacting with Institutional SMMPs should have similarly reduced quantitative-suitability obligations in instances where the dealer does not have actual control or de facto control over the account of an Institutional SMMP. This modification would effectively revert the quantitative suitability standard for Institutional SMMPs back to the longstanding standard that was in place under MSRB rules prior to June 30, 2020.²¹ The proposed Institutional SMMP Amendment is intended

²⁰ See supra note 10 for the applicable definition of “retail customer” and related citation. Any customer meeting such definition of retail customer pursuant to Regulation Best Interest would not be considered an Institutional SMMP for the purposes of the proposed Institutional SMMP Amendment and its modification to MSRB Rule G-48. For purposes of MSRB rules, such a customer meeting the definition of a “retail customer” would receive the protections afforded by Regulation Best Interest.

²¹ See Broker-Dealer Harmonization Filing, 85 FR at 28082, n. 4. The MSRB notes that it has had a long held prohibition against “churning,” and the MSRB formally “recast” this prohibition as quantitative suitability through an amendment to MSRB Rule G-19 approved by the SEC in 2014. See Exchange Act Release No. 71665 (Mar. 7, 2014), 79 FR 2432 (Mar. 13, 2014), File No. SR-MSRB-2013-07 (discussing the then-existing MSRB prohibition on churning and a proposed rule change to recast this prohibition using the phrase “quantitative suitability”), available at

to improve the efficiency of the municipal securities market without eroding investor protection by aligning the compliance burden associated with certain recommendations made by dealers to the reasonable expectations and capabilities of Institutional SMMPs – who by their nature are more sophisticated, non-natural-person customers and must affirmatively indicate their capacity to (i) exercise independent judgment and (ii) access material information.²²

Background on MSRB Rule G-19's Quantitative Suitability Requirements

MSRB Rule G-19 sets the MSRB's baseline investor protection standards regarding the suitability of recommendations made by dealers to their customers of purchases, sales, or exchanges of municipal securities that are not subject to Regulation Best Interest. Among other requirements, Supplementary Material .05 of MSRB Rule G-19 enumerates three components of a dealer's suitability analysis when recommending a transaction or investment strategy involving a municipal security or municipal securities to a non-retail customer (i.e., a recommendation that is not subject to Regulation Best Interest).²³ As further defined in the text of the rule, MSRB Rule G-19 provides that a dealer's suitability obligation is composed of (i) reasonable-basis suitability, (ii) customer-specific suitability, and (iii) quantitative suitability. Most relevant to the proposed Institutional SMMP Amendment of this proposed rule change, quantitative

http://www.msrb.org/~/_media/Files/SEC-Filings/2013/MSRB-2013-07-Fed-Reg-Approval.ashx?la=en&hash=AEDA0B5509630E25473E9F6F3A3F9C34.

²² See MSRB Rule G-48(c). See also related discussion infra under Background and Purpose of the Institutional SMMP Amendment - Background on MSRB Rule D-15 and SMMP Affirmation Requirements.

²³ See the Broker-Dealer Harmonization Filing, 85 FR at 28084. The Broker-Dealer Harmonization Filing amended MSRB Rule G-19 to provide that the rule does not apply to recommendations subject to Regulation Best Interest.

suitability requires a dealer to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in MSRB Rule G-19.²⁴ No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a dealer has violated the quantitative suitability obligation.²⁵

Pursuant to the amendments effectuated by the Broker-Dealer Harmonization Filing, discussed above and effective as of June 30, 2020, the quantitative suitability obligation of MSRB Rule G-19 no longer incorporates an element of control in relation to a customer's account.²⁶ As a result, dealers are currently obligated to conduct a quantitative suitability analysis under MSRB Rule G-19 when making recommendations to Institutional SMMPs, even in instances where the dealer does not have actual control or de facto control over the account. The obligation applies notwithstanding the fact that Institutional SMMPs self-identify under MSRB

²⁴ MSRB Rule G-19, Supplementary Material .05(c).

²⁵ Id.

²⁶ In other words, as of June 30, 2020, if the obligations of MSRB Rule G-19 attach to a dealer's recommendation, then the investor protections regarding quantitative suitability apply regardless of whether the dealer making the recommendation exercises any actual control or de facto control over the customer's account. The Broker-Dealer Harmonization Filing amended this language of Supplementary Material .05(c) to eliminate such control requirements, effectively extending the requirements of quantitative suitability to any customer account. See Broker-Dealer Harmonization Filing, 85 FR at 28084. June 30, 2020 was the compliance date for the amendments enacted by the Broker-Dealer Harmonization Filing. See Broker-Dealer Harmonization Filing, 85 FR at 28082, n. 4. Pursuant to the Broker-Dealer Harmonization Filing, the MSRB also notes that this quantitative suitability obligation applies uniformly to any dealer (i.e., the same regulatory obligations apply to both Broker-Dealers and Bank Dealers).

Rule G-48 and MSRB Rule D-15 as having the willingness and requisite investment sophistication to, for example, independently evaluate the recommendations of a dealer and the quality of a dealer's execution, as further discussed below.²⁷

Background on MSRB Rule G-48 and Modified Regulatory Obligations

MSRB Rule G-48 provides for modified dealer regulatory obligations under MSRB rules when dealing with certain customers that meet the definition of a Sophisticated Municipal Market Participant²⁸ (i.e., an SMMP). More specifically, when transacting with an SMMP customer, Rule G-48 modifies aspects of a dealer's baseline regulatory obligations in terms of: (i) time of trade disclosures,²⁹ (ii) transaction pricing,³⁰ (iii) bona fide quotations,³¹ (iv) best

²⁷ See MSRB Rule D-15(c) (requiring Institutional SMMPs to “affirmatively indicate,” among other things, that it is exercising independent judgment in evaluating (A) the recommendations of the dealer and (B) the quality of execution of the customer's transactions by the dealer).

²⁸ See discussion under Background and Purpose of the Institutional SMMP Amendment - Background on MSRB Rule D-15 and SMMP Affirmation Requirements near note 37 infra (discussing the definition of Sophisticated Municipal Market Participant under MSRB Rule D-15).

²⁹ MSRB Rule G-48(a) (“The broker, dealer, or municipal securities dealer shall not have any obligation under Rule G-47 to ensure disclosure of material information that is reasonably accessible to the market.”)

³⁰ MSRB Rule G-48(b).

³¹ MSRB Rule G-48(d) (“The broker, dealer, or municipal securities dealer disseminating an SMMP's ‘quotation’ as defined in Rule G-13, which is labeled as such, shall apply the same standards regarding quotations described in Rule G-13(b) as if such quotations were made by another broker, dealer, or municipal securities dealer.”)

execution,³² and (vi) suitability.³³ The modified regulatory obligations afforded to SMMPs under MSRB rules are intended to account for the distinct capabilities of certain sophisticated, non-retail customers and the varied types of dealer-customer relationships occurring in the municipal securities market.³⁴

Most relevant to the proposed Institutional SMMP Amendment, Rule G-48(c) currently modifies the suitability requirements of MSRB Rule G-19 by eliminating the requirement for dealers to conduct a customer-specific suitability analysis for recommendations made to an Institutional SMMP.³⁵ The operative provision of MSRB Rule G-48 provides that, “[w]hen making a recommendation subject to Rule G-19 and not Regulation Best Interest, Rule 15l-1 under the Act, a broker, dealer, or municipal securities dealer shall not have any obligation under Rule G-19 to perform a customer-specific suitability analysis.”³⁶ This relaxed customer-specific suitability obligation is generally aligned with the “independent judgment” affirmations a

³² MSRB Rule G-48(e) (“The broker, dealer, or municipal securities dealer shall not have any obligation under Rule G-18 to use reasonable diligence to ascertain the best market for the subject security and buy or sell in that market so that the resultant price to the SMMP is as favorable as possible under prevailing market conditions.”)

³³ MSRB Rule G-48(c).

³⁴ See, e.g., Exchange Act Release No. 67064 (May 25, 2012), 77 FR 32704 (June 1, 2012), File No. SR-MSRB-2012-05 (May 25, 2012) (approving an MSRB proposed rule change to relax certain qualifications for a dealer to afford a customer SMMP status in light of market developments regarding the increased availability of municipal securities market information and the desire of certain institutional customers to access alternative trading systems).

³⁵ Id. The amendments to MSRB Rule G-48 enacted by the Broker-Dealer Harmonization Filing carved out recommendations to customers that are subject to Regulation Best Interest from the rule’s modified standards. See Broker-Dealer Harmonization Filing, 85 FR at 28084-85.

³⁶ MSRB Rule G-48(c).

customer seeking SMMP status makes under MSRB Rule D-15. The proposed Institutional SMMP Amendment would likewise relax the quantitative suitability obligation for similar reasons, as further described in the following sections.³⁷

Background on MSRB Rule D-15 and SMMP Affirmation Requirements

MSRB Rule G-48 incorporates the definition of SMMP under MSRB Rule D-15 for purposes of defining which customers do (or do not) qualify as an SMMP for purposes of Rule G-48 and, therefore, MSRB Rule D-15 establishes the scope of potential customers who might qualify for MSRB Rule G-48's modified obligations. The SMMP definition of MSRB Rule D-15 enumerates three definitional components, which separately address: (i) the minimum qualifying traits and characteristics of an SMMP customer;³⁸ (ii) that a dealer must develop a reasonable basis for determining whether a customer has the requisite level of expertise and sophistication to be deemed an SMMP customer (the "SMMP Reasonable Basis Determination");³⁹ and (iii) what

³⁷ See Exchange Act Release No. 71665 (Mar. 7, 2014), 79 FR 14321 (Mar. 13, 2014), File No. SR-MSRB-2013-07 (Sept. 17, 2013) (codifying the relaxed customer-specific suitability obligation for recommendations made to SMMPs in MSRB Rule G-48 and the actual control or de facto control requirement, thereafter eliminated in 2020 as described herein, for the applicability of quantitative suitability to recommendations made to customers in MSRB Rule G-19).

³⁸ MSRB Rule D-15(a). A customer is only eligible to be treated as an SMMP if the customer is: (i) a bank, savings and loan association, insurance company, or registered investment company, (ii) a registered investment advisor, or (iii) a person or entity with total assets of at least \$50 million.

³⁹ MSRB Rule D-15(b). A customer is only eligible to be treated as an SMMP if the dealer has developed a reasonable basis to believe that the customer is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions and investment strategies in municipal securities. In addition, Supplementary Material .01 of MSRB Rule D-15 states that, as part of the reasonable-basis analysis, the dealer should consider the amount and type of municipal securities owned or under management by the customer.

affirmations a customer must communicate to the dealer regarding its own investment judgment and access to information in order to be appropriately deemed an SMMP customer (the “SMMP Customer Affirmations”).⁴⁰ In terms of the SMMP Customer Affirmations, MSRB Rule D-15(c) provides that the customer must affirmatively indicate to the dealer that (i) it is exercising independent judgment in evaluating the recommendations of the dealer; the quality of execution of the customer’s transactions by the dealer; and the transaction price for non-recommended secondary market agency transactions as to which the dealer’s services have been explicitly limited to providing anonymity, communication, order matching and/or clearance functions and the dealer does not exercise discretion as to how or when the transactions are executed;⁴¹ and (ii) it has timely access to material information that is available publicly through established industry sources as defined in MSRB Rule G-47(b)(i) and MSRB Rule G-47(b)(ii) (i.e., “material information” from “established industry sources,” such as EMMA website information and rating agency reports).⁴²

Thus, an institutional customer who self-identifies as an SMMP has freely affirmed to a dealer its willingness to be treated as a sophisticated customer with the capacity and resources to

⁴⁰ MSRB Rule D-15(c).

⁴¹ See MSRB Rule D-15(c)(1) (“The customer must affirmatively indicate that it: (1) is exercising independent judgment in evaluating: (A) the recommendations of the dealer; (B) the quality of execution of the customer’s transactions by the dealer; and (C) the transaction price for non-recommended secondary market agency transactions as to which (i) the dealer’s services have been explicitly limited to providing anonymity, communication, order matching and/or clearance functions and (ii) the dealer does not exercise discretion as to how or when the transactions are executed . . .”).

⁴² See MSRB Rule D-15(c)(2) (“The customer must affirmatively indicate that it . . . (2) has timely access to material information that is available publicly through established industry sources as defined in Rule G-47(b)(i) and (ii).”)

exercise its own independent judgment. In this way, the SMMP Customer Affirmations are designed to ensure that any customer treated as an SMMP has affirmatively and knowingly provided the grounds on which a dealer may afford such SMMP customer lesser protections under certain MSRB rules. As an additional investor protection safeguard beyond the requirement for SMMP Customer Affirmations, the SMMP Reasonable Basis Determination also requires a dealer to have a reasonable basis to believe that an SMMP customer is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions and investment strategies in municipal securities.⁴³ In this way, the SMMP Reasonable Basis Determination further ensures that an Institutional SMMP does in fact possess a more sophisticated understanding of the municipal securities market. Importantly, the proposed Institutional SMMP Amendment would not alter the SMMP Customer Affirmations, the SMMP Reasonable Basis Determination, nor any of the other definitional elements of MSRB Rule D-15.

Purpose and Intent of the Institutional SMMP Amendment to MSRB Rule G-48

The proposed Institutional SMMP Amendment would amend MSRB Rule G-48 to modify the quantitative suitability obligations of dealers when effecting transactions for their Institutional SMMPs. The proposed Institutional SMMP Amendment would require a dealer to conduct a quantitative suitability analysis only in situations where the dealer has actual control or de facto control over an Institutional SMMP's account.⁴⁴ As stated above, the proposed

⁴³ See MSRB Rule D-15(b) and Rule D-15 Supplementary Material .01.

⁴⁴ Where a dealer exercises actual control or de facto control over an Institutional SMMP's account, the dealer would still be required to perform a quantitative suitability analysis in accordance with Supplementary Material .05 of MSRB Rule G-19. Relatedly, if an Institutional SMMP limitedly provides its customer affirmation on a trade-by-trade basis, then the dealer would be required to comply with all aspects of MSRB Rule G-19,

amendments to MSRB Rule G-48 would narrowly reinstate the scope of suitability protections afforded to Institutional SMMPs in effect prior to the amendments effectuated by the Broker-Dealer Harmonization Filing and so should be a familiar regulatory concept to dealers and Institutional SMMPs alike.⁴⁵ More importantly, because each Institutional SMMP must self-identify as an SMMP by making the SMMP Customer Affirmations, as well as must fulfill the requirements associated with a dealer's SMMP Reasonable Basis Determination, the MSRB believes that the proposed Institutional SMMP Amendment will ease a regulatory burden on dealers that effectively replicates the sort of analysis an Institutional SMMP is willing and capable of performing itself. As a result, the proposed Institutional SMMP Amendment would align the compliance burden associated with certain recommendations made by dealers to the reasonable expectations and capabilities of Institutional SMMPs.

While the investor protection benefits associated with requiring dealers to perform a potentially duplicative suitability analysis can be appropriate in other circumstances,⁴⁶ the MSRB believes that the compliance burden associated with performing a quantitative suitability analysis on recommendations made to Institutional SMMPs outweighs the potential marginal

including both the quantitative suitability requirement and the customer-specific suitability requirement, for those recommendations for which the Institutional SMMP did not provide the applicable customer affirmation. See Supplementary Material .02 of MSRB Rule D-15 (discussing trade-by-trade affirmations).

⁴⁵ See supra note 21 and related discussion.

⁴⁶ For example, the MSRB believes that the obligation to perform quantitative suitability analyses under MSRB rules remains appropriate, regardless of the potential for such duplication, in circumstances of recommendations made to retail customers; non-retail, institutional customers who fail to meet the characteristics of an SMMP; and/or non-retail customers who have declined to make the affirmations necessary to be appropriately deemed an SMMP.

investor protection benefits. In this way, the proposed Institutional SMMP Amendment would promote efficiency in the municipal securities market by eliminating a regulatory burden on dealers that generally provides a duplicative or unneeded analyses in supplement of an Institutional SMMPs' own independent and informed judgment, and, consequently, the proposed Institutional SMMP Amendment would allow dealers to redirect the resources associated with this regulatory burden to other more productive market activities.

2. Statutory Basis

The MSRB believes that the proposed rule change is consistent with Section 15B(b)(2) of the Act,⁴⁷ which provides that the Board shall propose and adopt rules to effect the purposes of this title with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers and advice provided to or on behalf of municipal entities or obligated persons by brokers, dealers, municipal securities dealers, and municipal advisors with respect to municipal financial products, the issuance of municipal securities, and solicitations of municipal entities or obligated persons undertaken by brokers, dealers, municipal securities dealers, and municipal advisors.⁴⁸

Section 15B(b)(2)(C) of the Act⁴⁹ provides that the MSRB's rules shall be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal

⁴⁷ 15.U.S.C. 78o-4(b)(2).

⁴⁸ Id.

⁴⁹ 15 U.S.C. 78o-4(b)(2)(C).

securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest.⁵⁰ The MSRB believes the proposed rule change is consistent with Section 15B(b)(2)(C) of the Act⁵¹ for the following reasons.

Statutory Basis for the Best Interest Amendments

The proposed Best Interest Amendments are consistent with Section 15B(b)(2)(C) of the Act⁵² because the amendments would: foster cooperation and coordination with regulators; prevent fraudulent and manipulative acts and practices; protect investors; remove impediments to and perfect the mechanism of a free and open market in municipal securities; and promote capital formation in the municipal securities market.

Fostering Cooperation and Coordination with Regulators

The proposed Best Interest Amendments would foster cooperation and coordination with regulators by more tightly aligning the suitability obligations of MSRB Rule G-19 with the suitability obligations of Regulation Best Interest. By providing a uniform standard for all types of dealers, this alignment of the regulatory scheme applicable to retail municipal recommendations will foster greater cooperation and coordination among the MSRB and the SEC, as well as greater cooperation and coordination among the authorities that examine Broker-Dealers and Bank Dealers for compliance with MSRB rules.

⁵⁰ Id.

⁵¹ Id.

⁵² Id.

Protecting Investors and Preventing Fraudulent and Manipulative Act and Practices

The proposed Best Interest Amendments would protect investors and prevent fraudulent and manipulative acts and practices by extending the enhanced standards of conduct required by Regulation Best Interest to the retail municipal recommendations of Bank Dealers. As noted by the Commission in the adopting release for Regulation Best Interest, Regulation Best Interest enhances the broker-dealer standard of conduct beyond existing suitability obligations, and aligns the standard of conduct with retail customers' reasonable expectations by requiring broker-dealers, among other things, to: act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer; and address conflicts of interest by establishing, maintaining, and enforcing policies and procedures reasonably designed to identify and fully and fairly disclose material facts about conflicts of interest, and in instances where we have determined that disclosure is insufficient to reasonably address the conflict, to mitigate or, in certain instances, eliminate the conflict.⁵³

In addition, the Commission stated the enhancements contained in Regulation Best Interest are designed to improve investor protection by enhancing the quality of broker-dealer recommendations to retail customers and reducing the potential harm to retail customers that may be caused by conflicts of interest.⁵⁴ For the same reasons, the MSRB believes that extending Regulation Best Interest to the retail municipal recommendations of Bank Dealers would prevent

⁵³ Regulation Best Interest Adopting Release, 84 FR at 33318.

⁵⁴ Regulation Best Interest Adopting Release, 84 FR at 33321.

potential fraudulent and manipulative acts and practices and promote the protection of the retail customers of Bank Dealers.

Removing Impediments and Perfecting the Mechanisms of a Free and Open Market

The proposed Best Interest Amendments would remove impediments to and perfect the mechanism of a free and open market in municipal securities by applying a uniform regulatory standard for retail municipal recommendations that would promote parity regarding the regulatory obligations of Broker-Dealers and Bank Dealers and, thereby, reduce potential confusion among market participants as to which standard of conduct applies.

Promoting Capital Formation

The proposed Best Interest Amendments would not have a deleterious effect on capital formation in the municipal securities market and would have the potential to improve capital formation for the following reasons. Similar to the Commission's reasoning in its adoption of Regulation Best Interest,⁵⁵ the enhanced obligations of Regulation Best Interest may increase the efficiency of retail municipal recommendations and increase the attractiveness of Bank Dealer services for those retail customers who do not invest with a Bank Dealer because recommendations made by bank dealers are not currently subject to the additional standards of investor protection afforded by Regulation Best Interest. Additionally, by adopting a uniform regulatory standard for retail municipal recommendations across all dealers (i.e., across Bank

⁵⁵ Regulation Best Interest Adopting Release, 84 FR at 33462 (“The possibility that Regulation Best Interest may increase the efficiency of the recommendations provided by the associated persons of the broker-dealer may enhance the attractiveness of broker-dealer services for those investors who currently do not invest through broker-dealers. . . . If retail customers are more willing to participate in the securities markets through broker-dealers, Regulation Best Interest would have a positive effect on capital formation.”)

Dealers and Broker-Dealers), the overall attractiveness of the municipal securities activities of dealers may improve. Consequently, if more retail customers are more willing to participate in municipal securities activities, then the proposed Best Interest Amendments would promote capital formation in the municipal securities market.

Statutory Basis for the Institutional SMMP Amendment

The proposed Institutional SMMP Amendment is consistent with Section 15B(b)(2)(C)⁵⁶ of the Act because the amendment would facilitate transactions in municipal securities and remove impediments to and perfect the mechanism of a free and open market in municipal securities, while not compromising investor protection.

The proposed Institutional SMMP Amendment would facilitate transactions in municipal securities and remove impediments to and perfect the mechanism of a free and open market in municipal securities by reducing a compliance burden on dealers. The modification of a dealer's suitability obligations to eliminate the current requirement to perform a quantitative suitability analysis for recommendations in circumstances where the dealer does not have actual control or de facto control over an Institutional SMMP's account will eliminate what could potentially be duplicative analyses undertaken by dealers on behalf of Institutional SMMPs – analyses which Institutional SMMPs have already affirmed their capacity and expertise to conduct for themselves, and which the Institutional SMMPs presumably have taken upon themselves to perform. In this regard, the proposed Institutional SMMP Amendment will remove an impediment to the mechanisms of a free and open market in municipal securities and promote greater efficiency. By eliminating this regulatory burden, the proposed Institutional SMMP

⁵⁶ 15 U.S.C. 78o-4(b)(2)(C).

Amendment would allow dealers to redirect the resources associated with this regulatory burden to other more productive market activities. As a separate, but related benefit, the MSRB believes that the Institutional SMMP Amendment would allow dealers to more efficiently serve those Institutional SMMPs who may be seeking relatively greater transaction activity and/or are more comfortable taking on the risks associated with more frequent transaction activity.

The MSRB believes that the proposed Institutional SMMP Amendment to MSRB Rule G-48 will not compromise investor protections. The MSRB believes that allowing dealers to make recommendations to their Institutional SMMP customers without the burden of performing a quantitative suitability analysis is consistent with the SMMP Customer Affirmations and dealers' SMMP Reasonable Basis Determination. More specifically, the SMMP Customer Affirmations ensure that an Institutional SMMP itself believes that it has the requisite knowledge and judgment to be afforded SMMP status; and, as an additional safeguard to investor protection, the SMMP Reasonable Basis Determination separately ensures that the dealer also has a reasonable basis to conclude that an Institutional SMMP has the knowledge and sophistication to be treated as a SMMP based on supplemental factors beyond just the SMMP Customer Affirmations. If either definitional prong is not met, a dealer is not permitted to afford an institutional customer the status of a SMMP. Therefore, the MSRB believes that the proposed Institutional SMMP Amendment is generally consistent with an Institutional SMMP's more sophisticated understanding of (i) the commercial nature of its relationship with a dealer and (ii) the lesser regulatory standards of conduct governing the SMMP-dealer relationship.

In addition, the proposed Institutional SMMP Amendment would incorporate the concepts of actual control or de facto control. Reinstating these control elements would help address potential scenarios in which the ability of an Institutional SMMP to exercise independent

judgment is undermined or circumvented, such as when a dealer may not have formal discretionary authority over an Institutional SMMP's account, but nevertheless exercises de facto control over the account to, for example, engage in churning activity in clear contravention of an Institutional SMMP's investment interests.⁵⁷ The MSRB believes that incorporating the actual control or de facto control elements maintains baseline investor protections for Institutional SMMPs in such scenarios of greater dealer impropriety or intentional wrongdoing.

The MSRB also notes that new institutional customers, who otherwise would qualify as SMMPs but desire the additional investor protections afforded by quantitative suitability under MSRB Rule G-19, can decline to provide the required affirmations under MSRB Rule D-15.⁵⁸ Similarly, existing Institutional SMMPs could withdraw their SMMP status and obtain the suitability protections afforded by MSRB Rule G-19. This ability to self-identify as an Institutional SMMP will ensure that those institutional customers who desire additional investor protection can secure them under MSRB rules, and thus, require the dealers to undertake a quantitative suitability analysis.

Accordingly, the MSRB believes that the proposed Institutional SMMP Amendment would maintain essential safeguards for investor protection and, overall, not compromise investor protections inconsistent with Section 15B(b)(2)(C)⁵⁹ of the Act.

⁵⁷ See, e.g., Harry Gliksmann, 54 S.E.C. 471, 475 (1999) (upholding a NASD finding that a registered representative violated his suitability obligations by recommending frequent and short-term securities transactions even though the registered representative did not have written discretionary authority).

⁵⁸ See related discussion supra under Background and Purpose of the Institutional SMMP Amendment – Background on MSRB Rule D-15 and SMMP Affirmation Requirements. See also MSRB Rule D-15(c)(1)-(2).

⁵⁹ 15 U.S.C. 78o-4(b)(2)(C).

B. Self-Regulatory Organization’s Statement on Burden on Competition

Section 15B(b)(2)(C) of the Act⁶⁰ requires that MSRB rules not be designed to impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The MSRB considered the economic impact associated with the proposed rule change, including a comparison to reasonable alternative regulatory approaches, relative to the baseline.⁶¹ The MSRB believes the proposed rule changes would relieve a burden on competition and do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Necessity of Rule Change

Best Interest Amendments

As previously mentioned, the retail municipal recommendations made by Bank Dealers currently are outside the scope of Regulation Best Interest,⁶² and the municipal securities activities of Bank Dealers continue to be subject to the existing investor protection obligations of MSRB rules, including MSRB Rule G-19. The proposed Best Interest Amendments to MSRB Rule G-19 would require each Bank Dealer to comply with the requirements of Regulation Best Interest to the same extent as a Broker-Dealer must. The proposed Best Interest Amendments are

⁶⁰ Id.

⁶¹ See Policy on the Use of Economic Analysis in MSRB Rulemaking, available at <http://msrb.org/Rules-and-Interpretations/Economic-Analysis-Policy.aspx>. In evaluating whether there was a burden on competition, the Board was guided by its principles that required the Board to consider costs and benefits of a rule change, its impact on capital formation and the main reasonable alternative regulatory approach.

⁶² Regulation Best Interest applies to “a broker, dealer or a natural person who is an associated person of a broker or dealer,” which does not apply Bank Dealers. See 17 CFR § 240.151-1(a)(1).

necessary because they would increase investor protection in the municipal securities market by creating regulatory uniformity in the market between the municipal securities activities of Bank Dealers and those of Broker-Dealers, each of whom may provide retail municipal recommendations. Similar to the Broker-Dealer Harmonization Filing for Broker-Dealers in 2020, the MSRB believes another benefit of the proposed Best Interest Amendments is that the amendments would reduce agency costs and information asymmetry between Bank Dealers and retail customers.⁶³

The MSRB addresses reasonable alternatives where applicable when considering the costs, benefits, and impact of a proposed amendment. The MSRB believes the only reasonable alternative for evaluation is the option of leaving in place the current regulatory state in which a Bank Dealer's retail municipal recommendations are not subject to the requirements of Regulation Best Interest, while a Broker-Dealer's retail municipal recommendations are subject to the full requirements of Regulation Best Interest, even though the activities of both groups of dealers are similar. As shown below, the MSRB believes that maintaining the status quo would preserve a regulatory imbalance and therefore competitive imbalance in this regard between Bank Dealers and Broker-Dealers engaged in the same activity, as well as deprive certain retail customers of the investor protections afforded by Regulation Best Interest. In this way, maintaining the status quo would maintain a discrepancy in the investor protections afforded to the retail customers receiving retail municipal recommendations from Bank Dealers as compared

⁶³ The SEC describes this reduction in agency cost, in the Regulation Best Interest Adopting Release, as “the difference between the net benefit to the retail customer from accepting a less than efficient recommendation about a securities transaction or investment strategy, where the associated person or Broker-Dealer puts its interests ahead of the interests of the retail customer, and the net benefit the retail customer might expect from a similar securities transaction or investment strategy that is efficient for him or her.” See Regulation Best Interest Adopting Release, 84 FR at 33403.

to the investor protections afforded to retail customers receiving retail municipal recommendations from Broker-Dealers and, thereby, maintain a competitive imbalance in terms of the compliance burdens of Bank Dealers versus Broker-Dealers.

Institutional SMMP Amendment

The purpose of amending MSRB Rule G-48 is to reinstate the requirement that a dealer have actual control or de facto control with respect to Institutional SMMP accounts to trigger a dealer's quantitative suitability obligation. A prior rule provision, applying the quantitative suitability obligation only when a dealer had actual control or de facto control over the account, was removed as part of the Broker-Dealer Harmonization Filing; and, as a result, dealers currently have an obligation to conduct a quantitative suitability analysis for transactions with Institutional SMMP customers whether or not the dealer has actual control or de facto control over the Institutional SMMP's account. The proposed Institutional SMMP Amendment to MSRB Rule G-48 will clarify that the quantitative suitability requirement of MSRB Rule G-19 is only applicable to natural person SMMPs but not to Institutional SMMPs. Since the proposed Institutional SMMP Amendment reinstates a previous requirement in the MSRB's suitability rule, the MSRB considered the alternative of placing the reinstated requirement in MSRB Rule G-19 for all institutional entities but decided that MSRB Rule G-48 is a more appropriate place to incorporate the reinstated standard, as Institutional SMMPs are by their nature sophisticated entities that have freely affirmed and self-identified their capacity to independently evaluate dealers' recommendations.

Benefits, Costs and Effect on Competition

Best Interest Amendments

The proposed Best Interest Amendments to MSRB Rule G-19 would help create a uniform standard of investor protection for retail municipal recommendations. The proposed Best Interest Amendments to MSRB Rule G-19 would obligate a Bank Dealer to comply with Regulation Best Interest to the same extent as a Broker-Dealer making retail municipal recommendations. In this regard, the MSRB believes the effects of the proposed Best Interest Amendments would be similar and comparable to the effects resulting from when Broker-Dealers were first required to comply with Regulation Best Interest, though at a much smaller scale concerning only retail municipal recommendations.⁶⁴ Therefore, the MSRB believes that the SEC's estimates of the burdens on competition and benefits of applying Regulation Best Interest to Broker-Dealers is a reasonable reference point for analyzing burdens on competition and benefits of applying Regulation Best Interest to Bank Dealers' retail municipal recommendations. The MSRB therefore built upon the findings of the SEC's multiyear in-depth analysis for its analysis of the proposed Best Interest Amendments.

Notably, in the Regulation Best Interest Adopting Release, the SEC emphasized that it is “difficult to quantify such benefits and costs with meaningful precision” for Broker-Dealers and, particularly over long time periods, the quantification may be insufficiently precise and inherently speculative,⁶⁵ mainly due to the following factors, among others, (i) a lack of data on the extent to which Broker-Dealers with different business practices engage in disclosure and conflict mitigation activities to comply with existing requirements, and therefore how costly it

⁶⁴ See Regulation Best Interest Adopting Release, 84 FR at 33403.

⁶⁵ Id. The MSRB is not aware of any post-implementation study or other analysis that provides data on the costs and benefits of adopting Regulation Best Interest.

would be to comply with the proposed requirements;⁶⁶ (ii) Regulation Best Interest provides Broker-Dealers flexibility in how to comply with the obligations and, as a result, there could be multiple ways in which Broker-Dealers will satisfy their obligations;⁶⁷ and (iii) Regulation Best Interest may affect Broker-Dealers differently depending on their business model (e.g., full-service Broker-Dealer, Broker-Dealer that uses independent contractors, insurance-affiliated Broker-Dealer) and size.⁶⁸

The SEC further cautioned that the associated costs for each individual Broker-Dealer firm could not be anticipated because of the wide variation in size and scope of business practices across firms as well as the many unknown factors associated with the principles-based nature of the Regulation Best Interest.⁶⁹ The MSRB believes the same difficulties and complexities experienced by the SEC in attempting to analyze the economic effects of applying Regulation Best Interest to Broker-Dealers also applies to the MSRB's attempt to provide a meaningful quantitative estimate of the impact of the proposed Best Interest Amendments on Bank Dealers.⁷⁰

⁶⁶ See Regulation Best Interest Adopting Release, 84 FR at 33434.

⁶⁷ Id.

⁶⁸ Id.

⁶⁹ Id.

⁷⁰ The MSRB sought public comment to solicit data to use in a quantitative analysis relating to the proposed changes in its Request for Comments. While commenters did provide some specifics on the scope of Bank Dealers' activities that would be subject to the proposed Best Interest Amendments, the MSRB did not receive any quantitative estimate of the impact of the proposed Best Interest Amendments on Bank Dealers. In addition, the MSRB is not aware of any post-implementation study that provides data on the costs and benefits of adopting Regulation Best Interest.

While acknowledging these challenges, the MSRB attempted to determine the scope of activity that would be subject to the proposed Best Interest Amendments, which is summarized in [Table 1](#) below. The summary table provides an estimate of the number of Bank Dealers likely to be affected by the proposed Best Interest Amendments. The Bank Dealers were included in that table based on their market share of retail-sized dealer-to-customer trades in calendar year 2020 (i.e., dealer-to-customer trades with a par value of \$100,000 or less).⁷¹ Among the over 1,200 dealers registered with the MSRB, only 21 firms are registered as Bank Dealers. Those 21 Bank Dealers conducted only 1.6% of all retail-sized dealer-to-customer trades in municipal securities in 2020.⁷² Even among the 21 Bank Dealers, nearly all of this activity was concentrated in a small number of firms, with the top seven most-active Bank Dealers conducting the vast majority of all retail-sized customer trades in 2020 (about 99.5%). The remaining number of registered Bank Dealers were significantly less active in executing retail-sized trades with customers during that same period, with six Bank Dealers not executing any retail-sized customer trades over the course of the entire year and the remaining eight Bank Dealers altogether averaging a little over one retail-sized customer trade per day.

⁷¹ The MSRB does not have access to reliable data to determine the precise number of Bank Dealers who provide (or may provide) recommendations to investors who meet the definition of a retail customer. To develop a reasonable proxy, the MSRB analyzed market data to determine the number of retail-sized trades (par value at \$100,000 or less in this case). In the absence of more specific data about a trade, total par size of \$100,000 or less is commonly used in the municipal securities market as an indicator of a retail activity. Data were obtained from the MSRB's Real-Time Transaction Reporting System (RTRS) and the MSRB's registration database.

⁷² These figures are provided by an MSRB analysis with data obtained from MSRB's Real-Time Transaction Reporting System (RTRS) combined with existing registration data.

Table 1:
Market Share of Municipal Securities
Retail-Sized Customer Trades by Dealers
January 2020 – December 2020

Type of Dealers	Number of Retail-Sized Customer Trades	Market Share of Retail-Sized Customer Trades
Non-Bank Dealers	3,865,880	98.4%
Top Seven Bank Dealers	61,140	1.6%
All Fourteen Other Bank Dealers	325	0.0%

Source: MSRB analysis with data obtained from the MSRB’s Real-Time Transaction Reporting System (RTRS) and the MSRB’s registration database.

In developing these numbers, the MSRB believes they are likely overly inclusive of potential retail activity, because there is a high probability the numbers capture more trades than would be subject to the requirements of the proposed Best Interest Amendments. Nevertheless, the MSRB believes the numbers are a reasonable estimate for the purpose of this economic analysis and are conservative to the extent that they are more likely to over-estimate the potential burden on Bank Dealers than underestimate it. In terms of the limitations of this data, dealer-to-customer trades with a par value of \$100,000 or less are not always conducted with investors who would meet the definition of a retail customer under Regulation Best Interest, as representatives acting on behalf of non-retail customers potentially execute trades with a par value of \$100,000 or less (i.e., small institutional trades). Conversely, retail investors may execute trades above \$100,000 par value (i.e., large retail trades); however, the MSRB believes large retail trades occur less frequently and, thus, do not fully offset the more frequent occurrences of sub-\$100,000 par value non-retail trades.⁷³

⁷³ For example, one commenter, the Capital Markets Group of Commerce Bank (“CMG”) based in Kansas City, MO, stated that “For CMG, retail customers comprise approximately 9% of CMG’s total open account customer base. Further, only a portion of these retail accounts actually executed transactions in the last 12 months, comprising

Additionally, the MSRB acknowledges that the number of trades is not a reasonable proxy for the number of retail municipal recommendations. That is, the fact that a Bank Dealer executes a trade with an investor who meets the definition of a retail customer under Regulation Best Interest does not necessarily mean that the Bank Dealer has made a “recommendation” to such retail customer for purposes of Regulation Best Interest. The Bank Dealer may have, for example, executed a non-recommended trade at the customer’s request. Hence, the MSRB believes that some unknown number of these retail-sized trades would not be subject to the proposed Best Interest Amendments (i.e., the trades would not be subject to Regulation Best Interest).

Benefits

The MSRB believes extending the requirements of Regulation Best Interest to Bank Dealers would reduce or eliminate a regulatory imbalance between Bank Dealers, on the one hand, and Broker-Dealers, on the other, as the terms of Regulation Best Interest do not currently apply to Bank Dealers. The proposed Best Interest Amendments would both close a regulatory gap and also mitigate certain market risks and inefficiencies associated with a potentially lower compliance standard.⁷⁴ Therefore, the proposed Best Interest Amendments would protect retail

approximately 3% of CMG’s total customers” See letter from Erik Swanson, Managing Director, and Joseph Reece, Chief Compliance Officer, Capital Markets Group of Commerce Bank (“Commerce Bank”), not dated (the “Commerce Bank Letter”) in response to MSRB Notice 2021-06 (March 4, 2021).

⁷⁴ As one potential example, where a Bank Dealer and a Broker-Dealer are both subsidiary entities of a common parent holding company, the MSRB is concerned that the parent holding company may attempt to take advantage of any regulatory imbalance by utilizing a regulatory arbitrage strategy to move retail customer accounts to the subsidiary with the lowest compliance standard, and, thus, Broker-Dealers may relocate retail customer accounts to affiliated Bank Dealers to avoid compliance with Regulation Best Interest.

customers seeking investment recommendations and transacting in municipal securities, regardless of whether they are customers of a Broker-Dealer or a Bank Dealer. The MSRB believes retail customers receiving retail municipal recommendations should benefit from a uniform standard of enhanced investor protections, which would not be dependent upon the type of dealer entity making the retail municipal recommendation.

As to the overall merit of the proposed new requirements, they are intended to reduce Bank-Dealer retail customer agency costs by lessening conflicts of interest that currently exist between Bank Dealers and retail customers and reduce information asymmetries limiting the ability of retail customers to assess the efficiency of recommendations from Bank Dealers.⁷⁵

Costs

If the proposed Best Interest Amendments were enacted, the MSRB believes Bank Dealers would experience initial costs associated with establishing the revised policies and procedures to comply with the requirements of Regulation Best Interest, as well as the costs of ongoing compliance. The initial setup costs likely would be proportionately higher for smaller and less active Bank Dealers with fewer retail municipal recommendations than for the larger and more active Bank Dealers with more retail municipal recommendations, while the ongoing costs would likely be proportionate with each Bank Dealer's retail business activities.

Additionally, Bank Dealers with an affiliated Broker-Dealer that is subject to Regulation Best Interest likely would not experience as much initial set-up costs as other Bank Dealers because they can leverage established policies and procedures from their Broker-Dealers affiliates presumably in compliance with Regulation Best Interest.

⁷⁵ For a detailed discussion of the economic theory behind agency costs, please refer to the Regulation Best Interest Adopting Release, 84 FR at 33400-41.

The MSRB believes the average per-firm total costs (initial and ongoing) would be substantially lower for a Bank Dealer providing retail municipal recommendations that are *only* related to municipal securities, as compared to the overall costs associated with a Broker-Dealer providing recommendations to retail customers of securities transactions or investment strategies involving securities related to many different types of securities. On average, there are many more retail-sized trades in other types of securities – for example, equities, corporate bonds, treasury and agency securities, options, convertible bonds, mutual funds, and exchange-traded funds – than in municipal securities alone.⁷⁶ A Broker-Dealer subject to Regulation Best Interest incurs compliance costs any time it provides a recommendation to its retail customers on any security, while a Bank Dealer would only incur cost when it provides a retail municipal recommendation. As a result, the MSRB believes the average per-Bank Dealer total costs would not approach the per-Broker-Dealer level, as estimated by the SEC in relation to Regulation Best Interest. Table 2 provides an illustration of potential costs to be expected for a Bank Dealer with an average number of retail-sized trades in municipal securities as a result of the proposed rule change. Using the SEC’s estimates of initial cost and ongoing cost for 2,766 Broker-Dealers, the MSRB estimated the portion of the costs attributable to municipal securities only for a Broker-Dealer with an average number of retail-sized trades in municipal securities, with the assumption that the same Broker-Dealer would incur only 35% of the initial cost and one percent of the

⁷⁶ Based on the MSRB’s estimate, there were approximately five million retail-sized customer trades in municipal securities in 2018, compared to 6.8 million retail-sized customer trades in corporate bonds, 132.5 million retail-sized customer trades in treasury securities and 4.4 billion retail-sized customer trades in equities, which include exchange-traded funds.

ongoing cost if the Broker-Dealer only provided recommendations on municipal securities to retail customers.⁷⁷ The MSRB then applied the cost estimates to an average Bank Dealer.

Table 2:
Estimated Initial Setup and Ongoing Compliance Costs for an Average Bank Dealer

	Initial Cost	Ongoing Cost	Number of Retail-Sized Customer Trades
SEC Estimate			
Average Broker-Dealer (Non-Bank Dealer)	\$ 2,153,290	\$ 855,897	
Average Broker-Dealer Trading Municipal Bonds Only	\$ 753,651	\$ 8,559	5,523
Apply SEC Estimate to Average Bank Dealer Trading Municipal Bonds	\$ 753,651	\$ 4,590	2,962

Source: MSRB analysis with data obtained from the MSRB's Real-Time Transaction Reporting System (RTRS), MSRB's registration data and SEC's estimates of costs and benefits of applying Regulation Best Interest to Broker-Dealers.⁷⁸

Effect on Competition, Efficiency, and Capital Formation⁷⁹

⁷⁷ The MSRB's analysis focuses on four securities that have substantial retail customer trades: municipal securities, corporate bonds, treasury securities and equities, which include exchange-traded funds. To be conservative, all other securities, such as stock options, federal agency securities, mortgage-backed securities, asset-backed securities, mutual funds, etc., are assumed to have no retail trades. For the initial cost, the MSRB assumes a cost saving of 65% when establishing policies and procedures for one security only, municipal bonds, as opposed to for four securities, accounting for some fixed costs when working on a single security product. For the ongoing cost, the MSRB estimated the number of retail-sized customer trades for municipal securities that are likely based on a Broker-Dealer's recommendation relative to comparable retail-sized customer trades for corporate bonds, treasury securities and equities (including exchange-traded funds), and derived that the proportion for municipal securities would be less than one percent of the total. Conservatively, one percent is used for estimating the ongoing costs related to municipal securities. Data were obtained from the MSRB's Real-Time Transaction Reporting System (RTRS), MSRB's registration database, and SEC's estimates of costs and benefits of applying Regulation Best Interest to Broker-Dealers.

⁷⁸ See Regulation Best Interest Adopting Release, 84 FR at 33318.

⁷⁹ Capital formation is defined by the SEC on their website "What we do," available at <https://www.sec.gov/about/what-we-do#section2>. It refers to companies and entrepreneurs accessing America's capital markets to help them create jobs, develop innovations and technology, and provide financial opportunities for those who invest in them. *Id.*

The MSRB believes that, if the proposed Best Interest Amendments were adopted, there is a possibility some Bank Dealers that rarely execute retail-sized customer trades, assuming those trades represent retail municipal recommendations, may choose to forgo retail business entirely to avoid the costs of compliance with proposed Best Interest Amendments and Regulation Best Interest, or more narrowly, stop providing retail municipal recommendations to limit the costs of compliance. Therefore, some Bank Dealers may be impacted by the proposed Regulation Best Interest Amendments by deciding to forego retail municipal recommendations or retail customer business altogether, though the broader impact on competition in the municipal securities market is expected to be minor given these Bank Dealers' relatively minor presence in executing retail-sized trades for municipal securities currently; accordingly, even if those Bank Dealers choose to relinquish their retail business, there should not be any significant reduction in the supply of services to retail investors. On the other hand, the MSRB does not expect a significant alteration to the competitive landscape from retail investors' perspective if the proposed Best Interest Amendments were adopted, as retail investors rarely use Bank Dealers for retail trading. Moreover, for those retail investors who do choose Bank Dealers to conduct retail activities, their activities are concentrated in a small number of Bank Dealers who are less likely to withdraw from the retail business as a result of the burdens created by the proposed Best Interest Amendments.

The MSRB believes requiring Bank Dealers to comply with the requirements of Regulation Best Interest, when making retail municipal recommendations, would improve market efficiency by imposing the same requirements on Bank Dealers when making such recommendations as on Broker-Dealers under Regulation Best Interest. The harmonization of MSRB rule requirements for Bank Dealers with SEC requirements for Broker-Dealers would

create consistency for firms who have both Broker-Dealer and Bank Dealer subsidiaries, and, thus, would increase efficiency in terms of firms' compliance burdens. It also may encourage competition for retail customers among Bank Dealers (and between Bank Dealers and Broker-Dealers in some instances) to the extent that the disclosure of fees and conflicts of interest would increase transparency and facilitate more comparability across Bank Dealers and Broker-Dealers among retail investors, and, therefore, would further inform customers' decisions of whether to utilize a Bank Dealer versus a Broker-Dealer for transactions in municipal securities. In addition, the MSRB believes investors should benefit from receiving the same type of information from Bank Dealers and Broker-Dealers in relation to an investment recommendation. Therefore, as stated above, because of the creation of consistent regulatory requirements across Bank Dealers and Broker-Dealers for their retail municipal recommendations and the greater competition fostered by this consistency among firms serving retail customers, the MSRB believes that the proposed Best Interest Amendments would facilitate capital formation.

Institutional SMMP Amendment

The MSRB proposal to amend MSRB Rule G-48 would reinstate a previously existing actual control or de facto control standard for Institutional SMMP accounts for purposes of dealers' quantitative suitability obligations.

Benefits

The proposed Institutional SMMP Amendment to MSRB Rule G-48 would reduce the compliance burden for all dealers, including Bank Dealers and Broker-Dealers, by eliminating the requirements to undertake a quantitative suitability analysis for Institutional SMMPs when a dealer does not have actual control or de facto control over the customer's accounts. The requirement is not necessary because of the sophistication and differing needs of Institutional

SMMPs who have knowingly declined to have such requirements apply to them, as described herein.

Costs

The MSRB believes the proposed Institutional SMMP Amendment to MSRB Rule G-48 to modify the quantitative suitability obligation of a dealer in the limited circumstances provided under the proposed Institutional SMMP Amendment would have minimal costs associated, particularly since the intent was to reinstate an exemption from quantitative suitability previously enacted for all recommendations through MSRB Rule G-19. One potential one-time cost would be for all dealers, including Bank Dealers and Broker-Dealers, to update their policies and procedures. Because of the recent existence of the same actual control or de facto control standard that would be reestablished by the proposed Institutional SMMP Amendment, the MSRB believes this one-time change should be familiar to firms and the cost of compliance implementation will be reduced in this regard. Moreover, to the degree that dealers are likely to reintroduce the same standards in their policies and procedures as previously existed, the cost of implementation would be minimized.

In addition, one impetus of the Broker-Dealer Harmonization Filing was to harmonize the rule with Regulation Best Interest and FINRA Rule 2111 and to reduce inconsistency on suitability requirements between FINRA's rules and MSRB's rules. By amending MSRB Rule G-48 to provide a narrow exemption from the application of quantitative suitability, this rule would not be fully harmonized with FINRA Rule 2111, and, thus, would establish two standards for accounts across the corporate and municipal securities markets. The MSRB believes that this

lack of harmonization is justified in this instance for all the reasons stated herein,⁸⁰ including the fact that Institutional SMMPs are by their nature sophisticated entities that have affirmed and self-identified their capacity to independently evaluate dealers' recommendations of municipal securities transactions.

Effect on Competition, Efficiency, and Capital Formation

The MSRB believes the proposed Institutional SMMP Amendment to MSRB Rule G-48 would improve the operational efficiency of the municipal securities market by reintroducing the element of actual control or de facto control with respect to Institutional SMMP accounts that would trigger a dealer's quantitative suitability obligation, as dealers would have one fewer compliance burden. The MSRB does not expect that the proposed Institutional SMMP Amendment to MSRB Rule G-48 would harm competition in the municipal securities market, because the proposed Institutional SMMP Amendment would be applicable to all dealers and, therefore, any of the benefits and burdens created by the proposed Institutional SMMP Amendments would be evenly applied to all such firms transacting with Institutional SMMP customers and, thereby, avoid discriminatory impacts among dealer firms.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

On March 4, 2021, the Board published a request for comment seeking public feedback on requiring Bank Dealers to comply with Regulation Best Interest when making a retail municipal recommendation (the "Request for Comments").⁸¹ The Board received five comments

⁸⁰ See related discussion supra under Purpose and Intent of the Institutional SMMP Amendment to MSRB Rule G-48.

⁸¹ MSRB Notice 2021-06 (March 4, 2021).

letters in response to the Request for Comments.⁸² Each of these will be addressed below. The comment letters addressing the proposed Best Interest Amendments will be discussed separately from the one comment letter addressing the proposed Institutional SMMP Amendment.

Discussion of Comments Related to the Best Interest Amendments

The MSRB received four comment letters addressing the proposed Best Interest Amendments in response to its Request for Comments. Comments submitted by SIFMA and the Securities Association were supportive of the proposed Best Interest Amendments, while the comments submitted by the Bankers Association and Commerce Bank expressed concerns about the proposed Best Interest Amendments, generally, in terms of the consequences of the potential compliance burden in relation to Bank Dealers' limited retail customer activity, as further discussed below.

Support for a Uniform Regulatory Standard

SIFMA cited the goal of achieving regulatory parity among regulated entities as the reason for being in favor of the proposed rule change.⁸³ Specifically, the SIFMA Bank Dealer Letter stated that "SIFMA supports the proposed amendment to extend Regulation Best Interest to bank dealers, as defined in the notice" and that "we believe that regulatory parity among

⁸² Letter from Justin M. Underwood, Executive Director, American Bankers Association ("Bankers Association"), dated June 2, 2021 (the "Bankers Association Letter"); Letter from Christopher A. Iacovella, Chief Executive Officer, American Securities Association ("Securities Association"), dated May 27, 2021 (the "Securities Association Letter"); the Commerce Bank Letter; Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association ("SIFMA"), dated June 2, 2021 (the "SIFMA Bank Dealer Letter"); and Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, SIFMA, dated June 2, 2021 (the "SIFMA SMMP Letter").

⁸³ SIFMA Bank Dealer Letter at 2.

regulated entities, which this amendment achieves, is a worthwhile goal.”⁸⁴ The Securities Association cited a reduction in regulatory confusion and establishing Regulation Best Interest as the standard for Broker-Dealers and Bank Dealers as the reasons for being in favor of the proposed rule change.⁸⁵ The Securities Association stated that adopting Regulation Best Interest for bank dealers will “reduce regulatory confusion for municipal dealers and further establish [Regulation Best Interest] as the national standard for broker-dealers and bank dealers.”⁸⁶ Further, the Securities Association stated that “[it] appreciates the work by the MSRB in the Proposal to align their rules with the SEC and Financial Industry Regulatory Authority’s (FINRA) when possible so that broker-dealers are not subjected to multiple standards.”⁸⁷ As discussed above, the Board agrees with the commenters that the proposed Best Interest Amendments would benefit the municipal securities market through more uniform regulatory standards.

Concerns Regarding Bank Dealer’s Compliance Burden and Effects on Competition

Among other topics in the Request for Comments, the Board sought public input on the potential burdens associated with the proposed Best Interest Amendments and, in particular, if requiring Bank Dealers to comply with Regulation Best Interest would disincentivize Bank Dealers from engaging in certain municipal securities activities with retail customers.⁸⁸

Commerce Bank and the Bankers Association offered comments. The Bankers Association

⁸⁴ SIFMA Bank Dealer Letter at 1-2.

⁸⁵ Securities Association Letter at 1.

⁸⁶ Id. at 1.

⁸⁷ Id. at 2.

⁸⁸ Request for Comments at 7.

commented that, while its members have long supported the notion that financial professionals offering investment advice to retail customers should be subject to a best interest standard, the Bankers Association urged the Board to consider the compliance costs imposed by such a rule on Bank Dealers in relation to their limited amount of retail customer activity.⁸⁹ The Bankers Association continued, stating that, ultimately, Bank Dealers in municipal securities do not have a significant retail customer base to warrant a new regulatory compliance regime in this manner.⁹⁰

Echoing this concern regarding the potential compliance burden of the proposed Best Interest Amendments, Commerce Bank responded that they would assess the additional compliance costs that come with compliance with Regulation Best Interest and consider the elimination of providing recommendations for securities or strategies to retail customers.⁹¹ Commerce Bank also expressed concern that the compliance burden of the proposed Best Interest Amendments may cause it to eliminate or become uncompetitive in relation to certain underwriting activities, particularly for services provided to issuers utilizing retail order periods.⁹²

⁸⁹ Bankers Association Letter at 2

⁹⁰ Id.

⁹¹ Commerce Bank Letter at 2.

⁹² Commerce Bank Letter at 3 (“Assuming the amendments are approved as adopted and bank dealers begin to move away from providing services to retail customers, bank dealers that underwrite municipal bonds would need controls in place to ensure underwriting or related commitments are appropriate for any retail order periods required by an issuer. The potential impact may be a smaller number of underwriting firms available or willing to work with smaller issuers and public entities in the market, limiting the number of competitors available for either competitive or negotiated deals.”) In addition to the reasons discussed below, the MSRB observes that analogous concerns regarding such dampening effects of Regulation Best Interest’s requirements on the

While the Board believes that commenters' concerns regarding the potential compliance burden for Bank Dealers associated with the proposed Best Interest Amendments are valid, the Board also believes that the potential investor protection benefits associated with the proposed Best Interest Amendments outweigh these potential compliance burdens for Bank Dealers. The Bankers Association Letter and the Commerce Bank Letter articulated concerns regarding the potential compliance burden associated with the proposed Best Interest Amendments,⁹³ but these commenters did not specifically address why Bank Dealers face compliance burdens that are materially different from those faced by Broker-Dealers, who are already required to adhere to the enhanced suitability standards required by Regulation Best Interest. Consequently, the MSRB is unaware of any material distinctions between the municipal securities activities of Bank Dealers and Broker-Dealers that would persuade the MSRB to propose a non-uniform regulatory scheme of lesser investor protections for the retail municipal recommendations of Bank Dealers.

Moreover, in developing the proposed Best Interest Amendments, the MSRB observed that Regulation Best Interest did not adopt de minimis thresholds or other standards to exclude smaller regulated entities with lesser amounts of retail customer activity from Regulation Best Interest's baseline compliance burdens.⁹⁴ Relatedly, the Commission concluded that the final

competition for underwriting activities equally apply to Broker-Dealers. Yet, the Commission ultimately found that Regulation Best Interest would not have a deleterious effect on capital formation. See, generally, Regulation Best Interest Adopting Release, 84 FR at 33461 et seq.

⁹³ See, respectively, Bankers Association Letter at 2 and Commerce Bank Letter at 2 (noting that retail accounts account for approximately 9% of their total open accounts and only a portion of these accounts transacted in the previous twelve months).

⁹⁴ See, generally, Regulation Best Interest Adopting Release, 84 FR at 33485 et seq. (discussing impact on "Small Entities Subject to the Rule").

version of its Regulation Best Interest appropriately balanced the concerns of various commenters from larger and smaller entities.⁹⁵ Similar to the Commission’s determination, the MSRB believes that the proposed Best Interest Amendments are written to balance the interests of commenters, including the various types and sizes of dealer entities, to best achieve the important goals of enhancing retail investor protection and decision making, while preserving, to the extent possible, retail investor access (in terms of choice and cost) to differing types of municipal security investment services and municipal security products.

Relatedly, the MSRB observes that the Commission determined that Regulation Best Interest would not have a deleterious effect on capital formation.⁹⁶ More specifically, the Commission concluded that (i) the possibility that Regulation Best Interest may increase the efficiency of the recommendations provided by the associated persons of the broker-dealer may enhance the attractiveness of broker-dealer services for those investors who currently do not invest through broker-dealers,⁹⁷ and (ii) if retail customers are more willing to participate in the securities markets through broker-dealers, Regulation Best Interest would have a positive effect on capital formation.⁹⁸

⁹⁵ Regulation Best Interest Adopting Release, 84 FR at 33323 (“After careful consideration of the comments and additional information we have received, we believe that Regulation Best Interest, as modified, appropriately balances the concerns of the various commenters in a way that will best achieve the Commission’s important goals of enhancing retail investor protection and decision making, while preserving, to the extent possible, retail investor access (in terms of choice and cost) to differing types of investment services and products.”)

⁹⁶ See, generally, Regulation Best Interest Adopting Release, 84 FR at 33461 et seq.

⁹⁷ Regulation Best Interest Adopting Release, 84 FR at 33462.

⁹⁸ Id.

For similar reasons, the MSRB believes that the proposed Best Interest Amendments would not hinder capital formation in the municipal securities market, as suggested by the Commerce Bank Letter, such as in instances where there is less underwriter competition for small municipal issuers or municipal issuers who seek to utilize retail order periods. To the degree that retail municipal recommendations are subject to a uniform regulatory standard across Bank Dealers and Broker-Dealers, the MSRB believes that the proposed Best Interest Amendments may increase the efficiency of retail municipal recommendations and enhance the attractiveness of dealer's municipal security services. This uniform regulatory standard could draw more retail customers to the primary offering of municipal securities with retail order periods and, in this respect, incrementally reduce issuer borrowing costs.

Discussion of Comments Related to the Institutional SMMP Amendment

The Board did not seek separate comment on the proposed Institutional SMMP Amendment but did receive the SIFMA SMMP Letter as part of the Request for Comments, which was generally supportive of the proposed Institutional SMMP Amendment. SIFMA stated in the SMMP Letter that its members “feel strongly that the Quantitative Suitability Requirement in Rule G-19 should be clarified, and interpreted as applicable only to natural person SMMPs, but not to institutional SMMPs. Extending the Quantitative Suitability Requirement to all SMMPs would be unduly costly and burdensome.”⁹⁹ As discussed above, the Board agrees with the commenter that requiring a dealer to undertake a quantitative suitability analysis, when an institutional customer has already affirmatively opted out of receiving such an analysis, is an

⁹⁹ SIFMA SMMP Letter at 2.

unnecessarily burdensome requirement to place on dealer's recommendations to Institutional SMMPs.

SIFMA cited the MSRB's "history of treating SMMPs differently from non-SMMPs, based on a reasoned recognition of the differences between these two investor classes and the relative protections that should be afforded to both."¹⁰⁰ The Board agrees that in limited circumstances it is appropriate for certain investor classes to be afforded different protections under MSRB rules, as different classes can have differing levels of sophistication, differing risk tolerances, and differing investment goals. As noted above, the SMMP concept and the modified regulatory obligations afforded to SMMPs under MSRB rules are intended to account for the distinct capabilities of certain self-identifying, sophisticated, non-retail customers, as well as the varied types of dealer-customer relationships occurring in the municipal securities markets. Thus, the MSRB believes it is appropriate to afford Institutional SMMPs more finely tailored protections, and that the proposed Institutional SMMP Amendment would not erode the overall protections afforded to Institutional SMMPs.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period of up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be

¹⁰⁰ SIFMA SMMP Letter at 3.

disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to rule-comments@sec.gov. Please include File Number SR-MSRB-2022-02 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-MSRB-2022-02. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of the

MSRB. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2022-02 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, pursuant to delegated authority.¹⁰¹

Secretary

¹⁰¹ 17 CFR 200.30-3(a)(12).

MSRB Notice

2021-06

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Municipal Securities
Dealers, Investors,
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Notice Type
Request for Comment

Comment Deadline
June 2, 2021

Category
Fair Practice

Affected Rules
[Rule G-19](#)

Request for Comment on Application of Regulation Best Interest to Bank-Dealers

Overview

The Municipal Securities Rulemaking Board (“MSRB” or “Board”) seeks comment on a draft amendment to MSRB Rule G-19, on suitability of recommendations and transactions, that would require bank dealers¹ to comply with Rule 15l-1 (“Regulation Best Interest”)² of the Securities Exchange Act of 1934 (the “Exchange Act” or the “Act”) when making recommendations of securities transactions or investment strategies involving municipal securities to retail customers (the “request for comment”).³ In response to the recent adoption of Regulation Best Interest by the Securities and Exchange Commission (the “SEC” or the “Commission”), the draft amendment⁴ is intended to promote regulatory parity in the municipal market by extending the investor protections afforded by Regulation Best Interest to retail customers that

¹ Consistent with MSRB Rule D-8, the term “bank dealer” as used herein means “a municipal securities dealer which is a bank or a separately identifiable department or division of a bank as defined in rule G-1 of the Board.”

² Exchange Act Release No. 86031 (June 5, 2019), 84 FR 33318 (July 12, 2019) (adopting Rule 15l-1 under the Exchange Act) (“Regulation Best Interest Adopting Release”), available at <https://www.sec.gov/rules/final/2019/34-86031.pdf>. Regulation Best Interest is codified at 17 CFR 240. 15l-1.

³ Consistent with the definition in Regulation Best Interest, the term “retail customer” as used herein means “a natural person, or the legal representative of such natural person, who: (i) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and (ii) Uses the recommendation primarily for personal, family, or household purposes.” See Rule 15l-1(b)(1). As further discussed below, the draft amendment would make a bank dealer subject to this definition to the same extent as a broker-dealer (as hereinafter defined).

⁴ Text of the draft amendment is provided at the end of this request for comment.



Receive emails about
MSRB Notices.

receive a recommendation from a bank dealer regarding a municipal security.⁵

Comments should be submitted no later than June 2, 2021 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.⁶

Questions about this notice should be directed to David Hodapp, Director, Market Regulation, Justin Kramer, Assistant Director, Market Regulation, or Prairie Douglas, Attorney II, at 202-838-1500.

I. Background

Regulation Best Interest applies to broker-dealers, and natural persons who are associated persons of such broker-dealer firms (collectively, "broker-dealers" and, individually, each a "broker-dealer"). Specific to the municipal securities market, the new standards of conduct established by the Commission's Regulation Best Interest are triggered when such a broker-dealer makes a recommendation of securities transactions or investment strategies involving a municipal security to any person meeting the applicable definition of a retail customer.⁷ These standards of conduct had a

⁵ To lawfully effect transactions in municipal securities, brokers, dealers, and municipal securities dealers (collectively, "dealers" and, individually, each a "dealer") must be registered with the Commission as either a "broker-dealer" under Section 15(b)(1) of the Exchange Act or a "municipal securities dealer" under Section 15B(a)(2) of the Exchange Act. The MSRB understands that firms effecting retail customer transactions in municipal securities registered as broker-dealers are presently subject to Regulation Best Interest, while bank dealers registered as municipal securities dealers are not.

⁶ Comments generally are posted on the MSRB's website without change. Personal identifying information such as name, address, telephone number or email address will not be edited from submissions. Therefore, commenters should submit only information that they wish to make available publicly.

⁷ When it adopted Regulation Best Interest, the Commission stated:

the determination of whether a broker-dealer has made a recommendation that triggers application of Regulation Best Interest should turn on the facts and circumstances of the particular situation and therefore, whether a recommendation has taken place is not susceptible to a bright line definition. Factors considered in determining whether a recommendation has taken place include whether the communication "reasonably could be viewed as a 'call to action'" and "reasonably would influence an investor to trade a particular security or group of securities."

compliance date of June 30, 2020.⁸

A. Broker-Dealer MSRB Rule Alignment

The Commission's adoption of Regulation Best Interest created the potential for circumstances in which a broker-dealer firm making recommendations with respect to municipal securities would be subject to both Regulation Best Interest and also existing MSRB rules, like certain suitability obligations under MSRB Rule G-19. The MSRB believed that this overlap created the potential for competing regulatory schemes, with possibilities for conflict or duplication. In an effort to harmonize its rules, the MSRB filed a proposed rule change with the Commission on May 1, 2020 (the "MSRB Broker-Dealer Filing").⁹ As more fully described in the text of the proposed rule change, the MSRB Broker-Dealer Filing amended:

- MSRB Rule G-8, on books and records to be made by brokers, dealers, and municipal securities dealers, and MSRB Rule G-9, on preservation of records, to require a broker-dealer to maintain books and records required by Regulation Best Interest and the Related SEC Form CRS requirement;¹⁰

See Regulation Best Interest Adopting Release, 84 FR at 33335, *quoting* Exchange Act Release No. 83062 (April 18, 2018), at 83 FR 21574, 21593 (May 9, 2018); *see also* Frequently Asked Questions on Regulation Best Interest, Recommendation, available at <https://www.sec.gov/tm/faq-regulation-best-interest#recommendation> (Aug. 4, 2020).

⁸ See Regulation Best Interest Adopting Release, 84 FR at 33400 (setting June 30, 2020 as the compliance date for Regulation Best Interest).

⁹ See File No. SR-MSRB-2020-02 (May 1, 2020), available at <http://msrb.org/~media/Files/SEC-Filings/2020/MSRB-2020-02.ashx?>; *see also* Exchange Act Release No. 89154 (June 25, 2020), 85 FR 39613 (July 1, 2020), (hereinafter referred to as the "Approval Order for the MSRB Broker-Dealer Filing"). In developing the MSRB Broker-Dealer Filing, the MSRB also coordinated with the Financial Industry Regulatory Authority, Inc. ("FINRA") in order to harmonize with FINRA's proposed amendments to its rules in response to the Commission's adoption of Regulation Best Interest. *See* Exchange Act Release No. 89091 (June 18, 2020), 85 FR 37970 (June 23, 2020) (File No. SR-FINRA-2020-07).

¹⁰ See File No. SR-MSRB-2020-02. When the Commission adopted Regulation Best Interest, it amended Exchange Act Rules 17a-3 and 17a-4 to require broker-dealers to make and maintain records with respect to certain information collected from or provided to retail customers in connection with Regulation Best Interest. Because dealers may comply with these rules for purposes of transactions in municipal securities by their compliance with MSRB Rules G-8 and G-9, the Board amended MSRB Rules G-8 and G-9 to include the record making and recordkeeping requirements associated with Regulation Best Interest to ensure

- MSRB Rule G-19 to make clear that the rule’s suitability obligations apply to a broker-dealer in circumstances only when Regulation Best Interest does not apply;
- MSRB Rule G-20, on gifts, gratuities, non-cash compensation, and expenses of issuance, to require any permissible non-cash compensation of a broker-dealer to align with the applicable requirements of Regulation Best Interest; and
- MSRB Rule G-48, on transactions with sophisticated municipal market professionals, to make clear that the exception from the requirement to perform a customer-specific suitability analysis when making a recommendation to a sophisticated municipal market professional (*i.e.*, an “SMMP”), as defined in MSRB Rule D-15, is available only for recommendations that are subject to MSRB Rule G-19.

The Commission approved the amendment described in the MSRB Broker-Dealer Filing on June 25, 2020.¹¹

B. Bank Dealer MSRB Rule Alignment

Since the approval of the MSRB Broker-Dealer Filing, the MSRB has remained focused on how the Commission’s Regulation Best Interest affects the municipal securities market and interacts with the MSRB’s rule book. As stated in the MSRB Broker-Dealer Filing, the MSRB understands that the terms of Regulation Best Interest do not apply to bank dealers.¹² The MSRB preliminarily believes that the inapplicability of Regulation Best Interest to bank dealers has created the potential for certain recommendations made by a bank dealer to a retail customer to be subject to a lesser standard of conduct relative to Regulation Best Interest than if the same recommendation were made by a broker-dealer. Consequently, certain retail customers in municipal securities might be afforded different regulatory protections based solely on whether they are a customer of a bank dealer or

dealers are required to make and maintain the records regardless of which books and records rule they comply with.

¹¹ Approval Order for the MSRB Broker-Dealer Filing (citation at note 8 *supra*).

¹² Approval Order for the MSRB Broker-Dealer Filing, at 39614, fn. 15 (“To effect transactions in municipal securities, a person must be a Broker-Dealer subject to registration with the Commission under Section 15(b)(1) or a municipal securities dealer subject to registration with the Commission under Section 15B(a)(2) of the Exchange Act. . . . Bank Dealers are registered with the Commission under Exchange Section 15B(a)(2), and thus are not subject to Regulation Best Interest.” (internal citations omitted)).

broker-dealer. The MSRB is concerned that this difference could cause unintentional harms and confusion to retail investors in the municipal securities market and is issuing this request for comment for further input from market participants.¹³

II. Request for Comment

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

A. Application of Regulation Best Interest to Bank Dealers

The Commission stated in the Regulation Best Interest Adopting Release that the SEC rule “enhances the existing standards of conduct for broker-dealers beyond existing suitability obligations and aligns” the standard of conduct with a retail customer’s reasonable expectations, including by, among other things, requiring a broker-dealer to “act in the best interest of a retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer[.]”¹⁴ Currently, bank dealers are not subject to Regulation Best Interest and remain subject to the existing obligations of suitability for recommendations to retail customers under MSRB Rule G-19.¹⁵

Questions:

1. What are the potential benefits or harms of the MSRB harmonizing the standard of conduct applicable to a bank dealer’s recommendation of transaction or investment strategy, including account recommendations, with respect to a municipal security to a retail customer with the Commission’s Regulation Best Interest?

¹³ *Id* (“[B]ecause Bank Dealers can make recommendations of municipal securities transactions or investment strategies involving municipal securities to retail customers, the Board stated it plans to issue a separate Request for Comment on whether the Board will apply the requirements of Regulation Best Interest, through further amendments to MSRB rules, to Bank Dealers.”).

¹⁴ Regulation Best Interest Adopting Release, 84 FR at 33318.

¹⁵ See note 12 *supra* for citation to the Approval Order for the MSRB Broker-Dealer Filing discussing the applicable registration requirements under the Exchange Act.

2. Are the municipal securities activities of bank dealers significantly distinct from those of broker-dealers to warrant a different standard of conduct? If so, can you provide a more detailed explanation about how or why bank dealers' municipal securities activities are so dissimilar? If not, can you provide a more detailed explanation about how or why bank dealers' municipal securities activities are similar or the same?
3. Does this potential for differing regulatory obligations pose any specific harms or benefits to the municipal market? For example, would not amending the existing regulatory scheme incentivize retail customers to invest in municipal securities solely through a broker-dealer? Would not amending the existing regulatory scheme incentivize firms to move municipal securities business to a bank dealer affiliate or another type of municipal securities dealer entity?

B. Definitions of “Retail Customer” and “Recommendation”

Regulation Best Interest defines a “retail customer” as a “a natural person, or the legal representative of such natural person, who: (i) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and (ii) Uses the recommendation primarily for personal, family, or household purposes.”¹⁶ The Commission also stated that the determination of whether a broker-dealer has made a “recommendation” that triggers application of Regulation Best Interest turns on the facts and circumstances of the particular situation and, therefore, is not susceptible to a bright line definition.¹⁷

Questions:

4. If bank dealers are subject to the requirements associated with Regulation Best Interest, to better assess the compliance costs, what portion of a bank dealer's municipal securities business would be impacted?¹⁸ In general, how much of a bank dealer's municipal

¹⁶ See Exchange Act Rule 15l-1(b)(1).

¹⁷ Regulation Best Interest Adopting Release, 84 FR at 33335.

¹⁸ While the MSRB believes that a par value of \$100,000 or less is a reasonable proxy for retail customer trades, the MSRB also understands that a bank dealer could engage in a large volume of transactions at such par amounts but, nevertheless, may not have any “retail customers,” nor make any “recommendations,” as such terms are defined in Regulation Best Interest.

securities business relates to retail customers? How much of a bank dealer's retail customer business involves a recommendation?

5. Would amending the existing regulatory scheme to extend the application of the requirements associated with Regulation Best Interest to bank dealers incentivize bank dealers to eliminate certain municipal securities activities with retail customers? Please provide any specifics available in support of your answer.

C. Regulation Best Interest's "General Obligation" and Component Obligations

Regulation Best Interest imposes a "General Obligation" that requires a broker-dealer, ". . . when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer, shall act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer[.]"¹⁹ The Commission further states the General Obligation is satisfied only if a broker-dealer complies with four component obligations: (i) an obligation to make certain prescribed disclosures to the customer, before or at the time of the recommendation about the recommendation and the relationship between the retail customer and the broker-dealer (the "Disclosure Obligation");²⁰ (ii) an obligation to exercise reasonable diligence, care, and skill in making a recommendation (the "Care Obligation");²¹ (iii) an

¹⁹ 17 CFR 240.15I-1(a)(1).

²⁰ 17 CFR 240.15I-1(a)(2)(i). Staff of the Commission have summarized the Disclosure Obligation as requiring that a broker-dealer, ". . . prior to or at the time of the recommendation, provide the retail customer, in writing, full and fair disclosure of: all material facts relating to the scope and terms of the relationship with the retail customer; and all material facts relating to conflicts of interest that are associated with the recommendation." See *Regulation Best Interest: A Small Entity Compliance Guide*, available at https://www.sec.gov/info/smallbus/secg/regulation-best-interest#_edn1 (last accessed March 4, 2021) (the "SEC Staff Compliance Guide"). As further described therein, the SEC Staff Compliance Guide was prepared by the staff of the Commission to summarize and explain Regulation Best Interest, but is not a substitute for the rule itself. The publication states, "Only the rule itself can provide complete and definitive information regarding its requirements."

²¹ 17 CFR 240.15I-1(a)(2)(ii). Staff of the Commission have summarized the Care Obligation as requiring that a broker-dealer, ". . . exercise reasonable diligence, care, and skill when making a recommendation to a retail customer to: [i] understand potential risks, rewards, and costs associated with recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers; [ii] have a reasonable basis to believe the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards,

obligation to establish, maintain, and enforce reasonably designed written policies and procedures related to conflicts of interest (the “Conflict of Interest Obligation”);²² and (iv) an obligation to establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest (the “Compliance Obligation” and, together with the Disclosure Obligation, Care Obligation, and Conflict of Interest Obligation, the “Component Obligations”).²³

Questions:

6. If Regulation Best Interest’s General Obligation and its Component Obligations were made applicable to bank dealers, should the MSRB omit, supplement, or otherwise modify any of the requirements associated with Regulation Best Interest to account for the municipal securities activities of bank dealers? Why or why not? If so, specifically how should the obligations be omitted, supplemented, or modified?
7. As one example of the need for such modifications, the Disclosure Obligation requires a broker-dealer to disclose that it is acting in a broker-dealer capacity. How might the MSRB further amend the text of the Disclosure Obligation if Regulation Best Interest’s references to

and costs associated with the recommendation and does not place the interest of the broker-dealer ahead of the interest of the retail customer; and [iii] have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer’s best interest when viewed in isolation, is not excessive and is in the retail customer’s best interest when taken together in light of the retail customer’s investment profile.” See SEC Staff Compliance Guide, available at https://www.sec.gov/info/smallbus/secg/regulation-best-interest#Care_Obligation (last accessed March 4, 2021).

²² 17 CFR 240.15f-1(a)(2)(iii). Under the Conflict of Interest Obligation, a broker-dealer entity “must establish, maintain, and enforce written policies and procedures reasonably designed to address conflicts of interest associated with its recommendations to retail customers.” See SEC Staff Compliance Guide, available at https://www.sec.gov/info/smallbus/secg/regulation-best-interest#Conflict_of_Interest_Obligation (last accessed March 4, 2021).

²³ 17 CFR 240.15f-1(a)(2)(iv). Staff of the Commission have summarized the Compliance Obligation as requiring that a broker-dealer entity “establish, maintain and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest,” which is “an affirmative obligation with respect to the rule as a whole, and provides flexibility to allow [broker-dealer entities] to establish compliance policies and procedures that accommodate [each entity’s] business model.” See SEC Staff Compliance Guide, available at https://www.sec.gov/info/smallbus/secg/regulation-best-interest#Compliance_Obligation (last accessed March 4, 2021).

broker-dealers were effectively replaced with references to bank dealers?

D. Text of the Draft Amendment

The MSRB Broker-Dealer Filing that aligned the MSRB's rules to the Commission's Regulation Best Interest, among other changes, amended MSRB Rule G-19 to state that, "[t]his rule shall not apply to recommendations subject to Regulation Best Interest, Rule 15c-1 under the Act." The text of the draft amendment is provided at the end of this request for comment. The MSRB is considering various alternatives for how MSRB Rule G-19 might be amended to effectively require that, when making recommendations of securities transactions or investment strategies involving municipal securities to retail customers, a bank dealer must comply with Regulation Best Interest to the same extent as a broker-dealer. The MSRB is also considering, in the interest of harmonization, whether bank dealers should strictly look to the Commission's interpretations and guidance regarding the obligations of Regulation Best Interest, as well as the role of the MSRB in tailoring such interpretations and guidance to the activities of bank dealers.

Questions:

8. Are there specific suggestions for how the text of the MSRB rule book should be amended to make the requirements associated with Regulation Best Interest applicable to bank dealers? Are there reasonable regulatory alternatives to the draft amendment?
9. What are the benefits and costs of the MSRB relying on the Commission to provide adequate written interpretation and guidance to bank dealers on the application of Regulation Best Interest?
10. If bank dealers are not required to comply with Regulation Best Interest, are there other enhancements that could be made to MSRB Rule G-19 or other MSRB rules to provide additional or analogous investor protections with respect to engaging in a municipal securities transaction with a bank dealer?

III. Economic Analysis

Section 15B(b)(2)(C) of the Exchange Act requires that MSRB rules not be designed to impose any burden on competition not necessary or appropriate

in furtherance of the purposes of the Exchange Act.²⁴ The MSRB seeks comment on the economic effects of amending MSRB Rule G-19 to apply Regulation Best Interest to bank dealers.

A. Need for the Amendment

As previously mentioned, the Commission's Regulation Best Interest is not applicable to bank dealers,²⁵ and the municipal securities activities of bank dealers continue to be subject to the existing investor protection obligations of MSRB rules, including MSRB Rule G-19. The draft amendment proposed by this request for comment would require each bank dealer to comply with the requirements of Regulation Best Interest to the same extent as a broker-dealer must, by adding supplementary text to MSRB Rule G-19. Among other potential benefits and costs, the draft amendment would eliminate a potential regulatory imbalance in the market between the municipal securities activities of bank dealers and those of broker-dealers, each of whom may provide recommendations and effect transactions of municipal securities to retail customers. The MSRB believes another benefit of the draft amendment is that it would reduce agency costs²⁶ and information asymmetry between bank dealers and retail customers.

B. Baseline for Evaluation

When assessing the impact of an amendment, the MSRB establishes a baseline as a point of reference to evaluate the draft amendment's potential economic impact. This baseline enables the MSRB to compare the expected state of the municipal securities market with the draft amendment in effect. The MSRB views the economic impact of a draft amendment as the difference between the baseline state and the as-modified expected state.

²⁴ 15 U.S.C. 78q-4(b)(2)(C). An explanation of the MSRB's Policy on the Use of Economic Analysis in MSRB's Rulemaking can be found here: <http://msrb.org/Rules-and-Interpretations/Economic-Analysis-Policy.aspx>

²⁵ By its terms, Regulation Best Interest applies to "a broker, dealer or a natural person who is an associated person of a broker or dealer," which does not include the municipal securities activities of a bank dealer. 17 CFR 240.15l-1(a)(1).

²⁶ The SEC describes this reduction in agency cost, in the Regulation Best Interest Adopting Release, as "the difference between the net benefit to the retail customer from accepting a less than efficient recommendation about a securities transaction or investment strategy, where the associated person or broker-dealer puts its interests ahead of the interests of the retail customer, and the net benefit the retail customer might expect from a similar securities transaction or investment strategy that is efficient for him or her." See Regulation Best Interest Adopting Release, at 84 FR at 33403.

The *baseline state* for assessing the impact of the draft amendment is the current market and regulatory structure in which a bank dealer's municipal securities activities are not subject to the requirements of Regulation Best Interest and a retail customer of a bank dealer does not receive any of the possible enhanced protections afforded by Regulation Best Interest. The *expected state* for assessing the impact of the draft amendment is the predicted market and regulatory structure in which a bank dealer's securities activities are subject to Regulation Best Interest to the same extent as a broker-dealer.

C. Alternative Approaches

In considering the costs, benefits, and impacts of an amendment, the MSRB also addresses reasonable alternatives where applicable. Specific to the draft amendment proposed by this request for comment, the MSRB believes the only reasonable alternative for evaluation is the option of leaving in place the current regulatory state in which a bank dealer's municipal securities activities are not subject to the requirements of Regulation Best Interest, while a broker-dealer's municipal securities activities are subject to the full requirements of Regulation Best Interest. As shown below, the MSRB preliminarily believes that maintaining the status quo would preserve a regulatory imbalance in this regard between bank dealers and broker-dealers engaged in the same activity and also potentially deprive certain retail customers of the investor protections afforded by Regulation Best Interest.

D. Benefits, Costs and Effect on Competition

Pursuant to the MSRB's policy on economic analysis in rulemaking, the MSRB's economic analysis should address the likely costs and benefits of an amendment. The economic analysis assesses an amendment as if it were fully implemented against the context of the economic baselines, as discussed above. The MSRB is seeking, as part of this request for comment, additional data, or studies relevant to the costs and benefits of the draft amendment.

The draft amendment proposed by this request for comment would, for the first time, obligate a bank dealer to abide by the requirements of Regulation Best Interest when making recommendations of securities transactions or investment strategies involving municipal securities to retail customers. In this regard, the MSRB believes that the effects of the draft amendment would be similar and comparable to the effects resulting from when broker-dealers were first required to comply with Regulation Best Interest, though

at a much smaller scale concerning only municipal securities.²⁷ Therefore, the MSRB believes that the SEC's estimates of costs and benefits of applying Regulation Best Interest to broker-dealers is a reasonable reference point for analyzing the costs and benefits of applying Regulation Best Interest to the municipal securities activities of bank dealers. The MSRB intends to build upon the findings of the SEC's multiyear in-depth analysis for this draft amendment.

Notably, in the Regulation Best Interest Adopting Release, the SEC emphasized that it is "difficult to quantify such benefits and costs with meaningful precision" for broker-dealers and, particularly over long time periods, the quantification may be insufficiently precise and inherently speculative,²⁸ mainly due to the following factors, among others:

- "A lack of data on the extent to which broker-dealers with different business practices engage in disclosure and conflict mitigation activities to comply with existing requirements, and therefore how costly it would be to comply with the proposed requirements;"
- "Regulation Best Interest provides broker-dealers flexibility in how to comply with the obligations and, as a result, there could be multiple ways in which broker-dealers will satisfy their obligations;" and
- "Regulation Best Interest may affect broker-dealers differently depending on their business model (e.g., full service broker-dealer, broker-dealer that uses independent contractors, insurance-affiliated broker-dealer) and size."²⁹

The SEC further cautioned that the associated costs for each individual broker-dealer firm could not be anticipated "because of the wide variation in size and scope of business practices across firms as well as the many unknown factors associated with the principles-based nature of the Regulation Best Interest."³⁰ The MSRB believes that the same difficulties and complexities experienced by the SEC in attempting to analyze the economic effects of applying Regulation Best Interest to broker-dealers also applies to

²⁷ See Regulation Best Interest Adopting Release, 84 FR at 33403

²⁸ *Id.*

²⁹ See Regulation Best Interest Adopting Release, 84 FR at 33434.

³⁰ *Id.*

the MSRB's attempt to provide a meaningful quantitative estimate of the impact of the draft amendment on bank dealers.

While acknowledging these challenges, the MSRB attempted to determine the scope of activity that would be subject to the draft amendment, which is summarized in **Table 1** below. The summary table provides an estimate of the number of bank dealers likely to be affected by the draft amendment. The bank dealers were included in that table based on their market share of retail-sized dealer-to-customer trades in calendar year 2019 (*i.e.*, dealer-to-customer trades with a par value of \$100,000 or less).³¹ Among the over 1,200 dealers registered with the MSRB, only 21 firms are registered as bank dealers. Those 21 bank dealers conducted only 1.5% of all retail-sized dealer-to-customer trades in municipal securities in 2019.³² Even among the 21 bank dealers, nearly all of this activity was concentrated in a small number of firms, with the top seven most-active bank dealers conducting the vast majority of all retail-sized customer trades last year (about 99.5%). The remaining number of registered bank dealers were significantly less active in executing retail-sized trades with customers during that same period, with four bank dealers not executing any retail-sized customer trades over the course of the entire year and the remaining 10 bank dealers altogether averaging about one retail-sized customer trade per day.

³¹ The MSRB does not have access to reliable data to determine the precise number of bank dealers who provide (or may provide) recommendations to investors who meet the definition of a retail customer. To develop a reasonable proxy, the MSRB analyzed market data to determine the number of retail-sized trades (par value at \$100,000 or less in this case). In the absence of more specific data about a trade, total par size of \$100,000 or less is commonly used in the municipal market as an indicator of a retail activity.

³² These figures are provided by an MSRB analysis with data obtained from MSRB's Real-Time Transaction Reporting System (RTRS) combined with existing registration data.

Table 1:
Market Share of Municipal Securities
Retail-Sized Customer Trades by Dealers

January 2019 – December 2019

Type of Dealers	Number of Retail-Sized Customer Trades	Market Share of Retail-Sized Customer Trades
Non-Bank Dealers	3,989,811	98.5%
Top Seven Bank Dealers	61,909	1.5%
All Fourteen Other Bank Dealers	288	0.0%

Source: MSRB analysis with data obtained from the MSRB's Real-Time Transaction Reporting System (RTRS) and the MSRB's registration data.

In developing these numbers, the MSRB believes that they are likely overly inclusive of trading activity, because the numbers likely capture more trades than would be subject to the requirements of the draft amendment, but nevertheless the numbers are a reasonable estimate for purpose of this economic analysis. In terms of the potential limitations of this data, dealer-to-customer trades with a par value of \$100,000 or less are not always conducted with investors who would meet the definition of a retail customer under Regulation Best Interest,³³ as representatives acting on behalf of non-retail, institutional customers may also execute trades with a par value of \$100,000 or less (*i.e.*, small institutional trades). Conversely, retail investors may execute trades above \$100,000 par value (*i.e.*, large retail trades). On the whole, the MSRB believes that such large retail trades occur much less frequently and, thus, do not fully offset the more frequent occurrences of sub-\$100,000 par value institutional trades.

Additionally, the MSRB also acknowledges that the number of trades is not a reasonable proxy for the number of recommendations. That is, the fact that a bank dealer executes a trade with an investor who meets the definition of a retail customer under Regulation Best Interest does not necessarily mean that the bank dealer has made a "recommendation" to such retail customer for purposes of Regulation Best Interest. The bank dealer may have, for example, executed an unsolicited trade at the customer's request. Hence, the MSRB believes that a number of these trades would not be subject to Regulation Best Interest.

³³ It is the MSRB's understanding that, as a class of registered entities, bank dealers do not have a substantial retail presence.

i. Benefits

The MSRB preliminary believes that extending the requirements of Regulation Best Interest to bank dealers would reduce or eliminate a regulatory imbalance between bank dealers, on the one hand, and broker-dealers, on the other hand, as Regulation Best Interest does not by its terms apply to bank dealers. The draft amendment would both close a regulatory gap and also mitigate certain market risks associated with a potentially lower compliance standard.³⁴ To the extent that bank dealers make recommendations to retail customers, the draft amendment would also promote investor protection for retail customers seeking investment recommendations and transacting in municipal securities, regardless of whether they are customers of a broker-dealer or a bank dealer.

As to the overall merit of the proposed new requirements, they are intended to reduce bank dealer-retail customer agency costs by lessening conflicts of interest that currently exist between bank dealers and retail customers and reduce information asymmetries that would limit the ability of retail customers to assess the efficiency of recommendations from bank dealers. For a detailed discussion of the economic theory behind agency costs, please refer to the SEC Regulation Best Interest Adopting Release.

ii. Costs

If the draft amendment were enacted, the MSRB preliminarily believes that bank dealers would experience initial costs associated with establishing the revised policies and procedures to comply with the requirements of Regulation Best Interest, as well as costs of ongoing compliance. The initial setup costs likely would be proportionately higher for smaller and less active bank dealers than for the larger and more active bank dealers, while the ongoing costs would likely be proportionate with each bank dealer's retail business activities.

The MSRB preliminarily believes the average per-firm total costs (initial and ongoing) would be substantially lower for a bank dealer that provides recommendations *only* related to municipal securities as compared to the costs associated with a broker-dealer that provides recommendations to retail customers related to many different types of securities. On average, there are many more retail-sized trades in other types of securities (for

³⁴ As one potential example, where a bank dealer and a broker-dealer are both subsidiary entities of a common parent holding company, the MSRB is concerned that the parent holding company may take advantage of any regulatory imbalance by utilizing a regulatory arbitrage strategy to move retail customer accounts to the subsidiary with the lowest compliance standard, and, thus, broker-dealers may relocate retail customers accounts to affiliated bank dealers to avoid compliance with Regulation Best Interest.

example, equities, corporate bonds, treasury and agency securities, options, convertible bonds, mutual funds, and exchange-traded funds, *etc.*) than in municipal securities alone. A broker-dealer subject to Regulation Best Interest incurs cost any time it provides a recommendation to its retail customers on any security, while a bank dealer would only incur cost when it provides a recommendation to its retail customers on municipal securities under the draft amendment.

iii. Effect on Competition, Efficiency, and Capital Formation³⁵

The MSRB preliminarily believes that, if the draft amendment were adopted, some bank dealers that rarely execute retail-sized customer trades, assuming those trades represent recommendations to retail customers, may choose to forgo retail business entirely to avoid the costs of compliance with Regulation Best Interest or more narrowly stop providing recommendations to retail customers to limit the costs of compliance. Since bank dealers have a relatively minor presence in executing retail-sized trades for municipal securities, the MSRB preliminarily does not expect a significant alteration to the competitive landscape if the draft amendment were adopted. In other words, a regulated entity in competition with other regulated entities is not expected to be disadvantaged by the draft amendment.

The MSRB preliminarily believes that requiring bank dealers to comply with the requirements of Regulation Best Interest, when making recommendations of securities transactions or investment strategies involving municipal securities to retail customers, would improve market efficiency by imposing equivalent requirements on bank dealers when making such recommendations as on broker-dealers under Regulation Best Interest, and thus reduce confusion for firms and investors via harmonization of MSRB rule requirements with SEC requirements. It also may encourage competition for retail customers among bank dealers and broker-dealers to the extent that the disclosure of fees and conflicts of interest would increase transparency and facilitate comparability across bank dealers and broker-dealers. The MSRB preliminarily believes investors should benefit from receiving the same type of information from bank dealers and broker-dealers in relation to an investment recommendation. Therefore, the draft amendment would facilitate capital formation.

³⁵ Capital formation is defined by the SEC on their website “What we do,” available at <https://www.sec.gov/about/what-we-do#section2>. It refers to companies and entrepreneurs accessing America’s capital markets to help them create jobs, develop innovations and technology, and provide financial opportunities for those who invest in them.

Questions:

11. What are the potential costs of requiring bank dealers to comply with Regulation Best Interest? Can commenters provide specific data to quantify the potential costs of requiring bank dealers to comply with Regulation Best Interest?
12. Do you believe that the SEC's estimates of initial and ongoing costs to comply with Regulation Best Interest for broker-dealers with similar size and similar scale of activities in municipal securities can be applied to bank dealers?
13. If bank dealers become subject to Regulation Best Interest, what impact would that have on the municipal securities market? How would it affect capital formation? How would it affect competition?

March 4, 2021

* * * * *

Text of the Draft Amendment*

Rule G-19: Suitability of Recommendations and Transactions

A broker, dealer or municipal securities dealer must have a reasonable basis to believe that a recommended transaction or investment strategy involving a municipal security or municipal securities is suitable for the customer, based on the information obtained through the reasonable diligence of the broker, dealer or municipal securities dealer to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the broker, dealer or municipal securities dealer in connection with such recommendation.

This rule shall not apply to recommendations subject to Regulation Best Interest, Rule 15c-1 under the Act ("Regulation Best Interest"). When making recommendations of securities transactions or investment strategies involving municipal securities, a bank dealer shall comply with Regulation Best Interest to the same extent as a broker or dealer.

Supplementary Material

No Change.

* Underlining indicates new language; strikethrough denotes deletions.

ALPHABETICAL LIST OF COMMENT LETTERS ON NOTICE 2021-06 (MARCH 4, 2021)

1. American Bankers Association: Letter from Justin M. Underwood, Executive Director, dated June 2, 2021
2. American Securities Association: Letter from Christopher A. Iacovella, Chief Executive Officer, dated May 27, 2021
3. Capital Markets Group of Commerce Bank: Letter from Erik Swanson, Managing Director, and Joseph Reece, Chief Compliance Officer, not dated
4. Securities Industry and Financial Markets Association: Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, dated June 2, 2021 (the “SIFMA Bank Dealer Letter”)
5. Securities Industry and Financial Markets Association: Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, dated June 2, 2021 (the “SIFMA SMMP Letter”)



Building Success. Together.

Justin M. Underwood
Executive Director - ABASA
Vice President, Banking Policy
202-663-5273
junderwood@aba.com

SUBMITTED ELECTRONICALLY

June 2, 2021

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1300 I Street NW, Suite 1000
Washington, D.C. 20005

RE: Municipal Securities Rulemaking Board Requests for Comment on Application of Regulation Best Interest to Bank-Dealers (Notice 2021-06)

The American Bankers Association¹ (ABA) appreciates the opportunity to provide comments to the Municipal Securities Rulemaking Board (MSRB or Board) on the draft amendment to MSRB Rule G-19, on the suitability of recommendation on transactions that would require bank dealers to comply with Rule 15/-1 of the Securities Exchange Act of 1934 when making recommendations on securities transactions or investment strategies involving municipal securities to retail customers.² Specifically, the Board is requesting input from stakeholders to harmonize the municipal market regulations to include bank dealers in the SEC's Regulation Best Interest.

The draft amendment would impose a standard of conduct on bank dealers when recommending to retail customers in the municipal securities market. Many ABA members provide services as regulated municipal securities dealers through separately identifiable

¹ The American Bankers Association is the voice of the nation's \$22.5 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard nearly \$18 trillion in deposits, and extend nearly \$11 trillion in loans. Learn more at www.aba.com.

² See MSRB Notice 2021-06.

departments in commercial banks or through broker-dealer affiliates of commercial banks. These services and products are frequently offered under various regulatory and legal regimes, which are governed by state and federal laws, and supervised by multiple regulatory agencies. The Request for Comment, while directed at bank dealers, is also of interest to our broker-dealer and bank members. Our comments herein will be focused on these various perspectives.

General Comments

While ABA has long supported the notion that financial professionals offering investment advice to retail customers should be subject to a best interest standard, we urge the Board to consider the compliance costs imposed by such a rule on bank dealers in relation to their limited amount of retail customer activity. Board data has shown that the overwhelming amount of retail-sized (< \$100K par value) bank dealer-to-customer trades were concentrated among seven (7) of the 21 existing bank dealers and four (4) of the 21 bank dealers did not execute any retail-sized trades.³ Ultimately, bank dealers in municipal securities do not have a significant retail customer base to warrant a new regulatory compliance regime in this manner.

Specific Comments on the Proposed Amendment

Costs

Among the chief concerns of ABA members are the expected costs associated with establishing the revised policies and procedures to comply with Regulation Best Interest's requirements and the expected ongoing compliance costs. The Board believes these costs would be proportionate to each bank dealer's limited retail activity. Most dealer banks do not engage in trades with retail customers nor typically in amounts less than \$100,000 par value. Nonetheless, these institutions may find themselves potentially in a transaction with a retail customer through no effort on the part of the bank. The Request for Comment acknowledges that because a trade is

³ See MSRB Notice 2021-06 pg. 13

less than \$100K, it does not imply that these trades are conducted with only retail customers and could be executed for institutional trades.⁴ Per the example above, we would encourage the MSRB to consider a thoughtful and tailored approach to this rulemaking so the bank dealer would not incur any additional cost or require additional documentation if the trades were not subject to Regulation Best Interest.

Further, if a bank dealer has to track or report this type of activity, there would be a cost to doing so only to prove the bank is complying with Regulation Best Interest even though the bank dealer does not offer any sales to retail clients. The MSRB should consider the burden on the bank dealer to establish revised policies and procedures related to the compliance of Regulation Best Interest and allow for those bank dealers who do not participate in retail transactions or recommendations to “opt-out” of Regulation Best Interest.

Disclosure of Fees

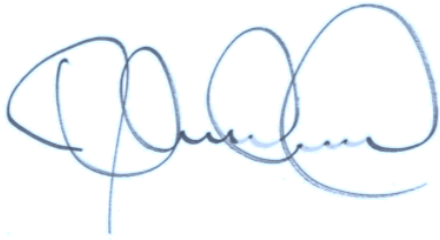
The disclosure of fees and conflicts of interest required for broker-dealer activity with retail customers is another concern for ABA’s bank dealer members. There is a possibility that if bank dealers are required to comply with Regulation Best Interest with retail transactions, it could open up similar compliance related to their institutional businesses. In light of the higher costs associated with the implementation of the proposed requirements and in all likelihood, the ongoing costs, the Board should take this into consideration given the small number of bank dealers practicing in the market today.

Conclusion

⁴ See MSRB Notice 2021-06 pg. 14

ABA appreciates this opportunity to provide the perspective of our bank dealers and banks. We offer our suggestions intending to improve the effectiveness of the proposed amendment and ensure compliance costs and burden are proportional to their activities.

Sincerely,

A handwritten signature in blue ink, appearing to read "Justin M. Underwood". The signature is fluid and cursive, with a large initial "J" and "U".

Justin M. Underwood
Executive Director – ABASA
Vice President, Banking Policy
American Bankers Association



May 27, 2021

Mr. Ronald Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1300 I Street NW, Suite 1000
Washington, DC 20005

Re: Request for Comment on Application of Regulation Best Interest to Bank-Dealers (2021-06)

Dear Mr. Smith:

The American Securities Association (ASA)¹ appreciates this opportunity to comment on the Municipal Securities Rulemaking Board's (MSRB) proposal to amend MSRB rules to harmonize standards of conduct for bank dealers with the Securities and Exchange Commission's (SEC) Regulation Best Interest (Reg BI), which went into effect on June 30, 2020 (Proposal).

The ASA has strongly supported Reg BI, which was finalized by the Securities and Exchange Commission in June 2019. Reg BI is a strong national standard that includes significant investor protections and establishes clear rules for broker-dealers, without crippling business models that have served investors well for years. Having a national standard has become increasingly important given efforts by certain states to undermine Reg BI by adopting their own conflicting standards which confuse investors, increase costs, and reduce access to advice.

Reg BI requires broker-dealers to consider several factors when providing advice and making recommendations to retail investors. This includes considering the potential risks, rewards, and costs associated with recommendations, and a prohibition against a broker putting their own interest ahead of their clients. Reg BI raises the bar for the entire broker-dealer industry and will prevent bad actors from taking advantage of vulnerable investors.

The adoption of Reg BI requires MSRB to align its rules with the new national standard. In 2020, the SEC approved a number of MSRB proposals to align rules G-8, G-19, G-20, and G-48 for broker-dealers when interacting with retail customers.² The Proposal would further amend MSRB Rule G-19 regarding suitability to align Reg BI with standards that apply to bank dealers (defined as a municipal dealer that is a bank or a separate department or division of a bank). While technical in nature, the Proposal will reduce regulatory confusion for municipal dealers and further establish Reg BI as the national standard for broker-dealers and bank dealers.

¹ The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership of almost one hundred members that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

² Approval Order for the MSRB Broker-Dealer Filing (June 25, 2020)





The ASA appreciates the work by the MSRB in the Proposal to align their rules with the SEC and Financial Industry Regulatory Authority's (FINRA) when possible so that broker-dealers are not subject to multiple standards. We thank the MSRB for advancing this Proposal and look forward to working with the Board to ensure that Reg BI meets its intended goals.

Sincerely,

Christopher A. Iacovella
Chief Executive Officer
American Securities Association





1000 Walnut St.
Kansas City, MO 64106

Mr. Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1300 I Street NW, Suite 1000
Washington, DC 20005

Re: Notice 2021- 06, Request for Comment on Application of Regulation Best Interest to Bank-Dealers

Dear Mr. Smith,

The Capital Markets Group of Commerce Bank (“CMG”) respectfully submits these comments in response to MSRB Notice 2021-06. The Capital Markets Group is a department of Commerce Bank (“Commerce”) and is a registered bank-dealer. Commerce Bank, a subsidiary of Commerce Bancshares, Inc., is a Federal Reserve Member, Missouri Trust Company operating full service banking facilities across the Midwest including the St. Louis and Kansas City metropolitan areas, Springfield, Central Missouri, Central Illinois, Wichita, Tulsa, Oklahoma City, and Denver. We appreciate the opportunity to share our observations and comments in regard to the potential impact and effect of the proposed application of Regulation Best Interest on bank-dealers.

The Request for Comment invites market participants to provide comments in response to several questions and topics posed in regard to Regulation Best Interest. As noted by the MSRB, the terms of Regulation Best Interest (“Regulation BI”) do not currently apply to bank dealers. Specifically, the MSRB is seeking comment on a draft amendment to MSRB Rule G-19, requiring bank dealers to comply with Regulation Best Interest when making recommendations of securities transactions or investment strategies involving municipal securities to retail customers.

Our comments with the corresponding Item Number from the Notice are as follows:

2. Are the municipal securities activities of bank dealers significantly distinct from those of broker-dealers to warrant a different standard of conduct? If so, can you provide a more detailed explanation about how or why bank dealers’ municipal securities activities are so dissimilar?

Although we cannot speak with direct knowledge of other bank dealers, we can provide applicable details about the activities of CMG. The majority of CMG’s customers and related activity are institutional in nature, comprising over 91% of open accounts, and with many of the institutional customers designated as SMMPs. CMG does not actively market or seek to obtain new retail customer accounts. Many of our retail clients are related parties to the institutions we serve. For example, many CMG retail customers are typically more sophisticated and are familiar with fixed income products and securities markets. Also, as a bank dealer, CMG is generally only permitted to offer fixed income type products. Our retail customers are aware of this product constraint and utilize CMG services for only a portion of their overall personal portfolios.



1000 Walnut St.
Kansas City, MO 64106

4. If bank dealers are subject to the requirements associated with Regulation Best Interest, to better assess the compliance costs, what portion of a bank dealer's municipal securities business would be impacted? In general, how much of a bank dealer's municipal securities business relates to retail customers? How much of a bank dealer's retail customer business involves a recommendation?

For CMG, retail customers comprise approximately 9% of CMG's total open account customer base. Further, only a portion of these retail accounts actually executed transactions in the last 12 months, comprising approximately 3% of CMG's total customers. As discussed above, the majority of CMG's customers are institutional in nature. In general, most CMG customers may currently be provided recommendations. Given the potential applicability of Regulation BI, internal consideration and assessments will now need to be performed to determine whether recommendations would continue for any CMG retail customers.

5. Would amending the existing regulatory scheme to extend the application of the requirements associated with Regulation Best Interest to bank dealers incentivize bank dealers to eliminate certain municipal securities activities with retail customers? Please provide any specifics available in support of your answer.

Given the significant existing suitability and documentation requirements applicable to CMG's current retail customers, the additional increased requirements, risks, and costs associated with Regulation BI will continue to be assessed. As a result of this review, consideration will most likely be given to the potential removal of retail customers from the CMG platform. In addition, CMG may also consider the elimination of providing recommendations for securities or strategies to retail customers.

6. If Regulation Best Interest's General Obligation and its Component Obligations were made applicable to bank dealers, should the MSRB omit, supplement, or otherwise modify any of the requirements associated with Regulation Best Interest to account for the municipal securities activities of bank dealers? Why or why not? If so, specifically how should the obligations be omitted, supplemented, or modified?

As previously outlined in our response to Question 2, important distinctions exist for retail customers of CMG when compared to a general securities broker-dealer model. For example, the sophistication level of the customers, as well as the regulatory limitations that govern the products permitted to be provided by bank dealers. Given these distinctions and the costs associated with developing a robust program to comply with Regulation BI, we propose the MSRB consider the possibility of omitting or modifying the requirements applicable to bank dealers. As previously stated, the number of retail accounts that comprise CMG's customer base is relatively small, when compared to the number of institutional customers. As currently proposed, the full requirements of Regulation BI would apply to a bank dealer in the absence of any consideration for the number of retail accounts. We propose the MSRB consider a threshold for applicability of Regulation BI, such as the percentage of retail customers that comprise a bank dealers customer base.



1000 Walnut St.
Kansas City, MO 64106

13. If bank dealers become subject to Regulation Best Interest, what impact would that have on the municipal securities market? How would it affect capital formation? How would it affect competition?

Assuming the amendments are approved as adopted and bank dealers begin to move away from providing services to retail customers, bank dealers that underwrite municipal bonds would need controls in place to ensure underwritings or related commitments are appropriate for any retail order periods required by an issuer. The potential impact may be a smaller number of underwriting firms available or willing to work with smaller issuers and public entities in the market, limiting the number of competitors available for either competitive or negotiated deals. This may negatively impact a municipality's cost to borrow.

Thank you for the consideration of perspectives and information from the industry. We are certainly available to provide further details or aspects of this proposal for bank dealers.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "EAS", with a long horizontal flourish extending to the right.

Erik Swanson
Managing Director
Capital Markets Group of Commerce Bank

A handwritten signature in black ink, appearing to read "Joe R", with a long horizontal flourish extending to the right.

Joseph Reece
Chief Compliance Officer - CMG
Capital Markets Group of Commerce Bank



June 2, 2021

VIA ELECTRONIC SUBMISSION

Ronald W. Smith
 Corporate Secretary
 Municipal Securities Rulemaking Board
 1300 I Street NW, Suite 1000
 Washington, DC 20005

Re: MSRB Notice 2021-06 – Application of Regulation Best Interest to Bank Dealers

Dear Mr. Smith,

The Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates this opportunity to comment on the Municipal Securities Rulemaking Board’s (“MSRB”) Notice 2021-06 (the “Notice”),² which proposes an amendment to MSRB Rule G-19 that would require bank dealers to comply with Securities Exchange Act Rule 15/-1 (“Regulation Best Interest”) when making recommendations of securities transactions or investment strategies involving municipal securities to retail customers.³ SIFMA supports the proposed amendment to extend

¹ SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry’s nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

² MSRB Notice 2021-06 (March 4, 2021).

³ SIFMA notes that per SEC No-Action relief, “Institutional Family Offices” are not subject to Reg BI. The no-action relief defines “Institutional Family Office” as:

- 1) one or more experienced securities or financial service professionals;
- 2) total assets of \$50 million or more;
- 3) independent of the BD; and
- 4) supervision, i.e., policies and procedures/records to comply/demonstrate compliance with the relief.

See: <https://www.sec.gov/divisions/marketreg/mr-noaction/2020/sifma-122320-regbi.pdf>

SIFMA subsequently released two related forms: 1) an affirmative confirmation of status, and 2) a negative consent confirmation of status of Institutional Family Office. Both forms are available at <https://www.sifma.org/resources/general/cross-product/#isc>.

Regulation Best Interest to bank dealers, as defined in the Notice. Although our members do not normally conduct retail activity through their affiliated banks that would implicate this rule, we believe that regulatory parity among regulated entities, which this amendment achieves, is a worthwhile goal.

If any questions regarding the foregoing, please contact me at (212) 313-1130 or lnorwood@sifma.org.

Sincerely,

A handwritten signature in black ink, appearing to be 'L. Norwood', written in a cursive style.

Leslie M. Norwood
Managing Director
and Associate General Counsel



June 2, 2021

VIA ELECTRONIC SUBMISSION

Jake Lesser
 General Counsel
 Municipal Securities Rulemaking Board
 1300 I Street NW, Suite 1000
 Washington, DC 20005

Re: SIFMA Concerns Regarding Amendments to Rules G-19 and G-48

Dear Mr. Lesser,

The Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates this opportunity to address an issue regarding recent amendments to Rules G-19 and G-48 with the Municipal Securities Rulemaking Board (“MSRB”). As the MSRB continues its retrospective review of its rulebook, we appreciate the MSRB’s willingness to listen to industry members regarding their thoughts on the rulebook. We welcome this opportunity for a constructive conversation on this issue with the MSRB.

On June 25, 2020, the Municipal Securities Rulemaking Board (MSRB) received approval² from the U.S. Securities and Exchange Commission (“Commission”) for amendments to MSRB rules that aligned MSRB rules to the Commission’s then recently adopted Rule 15l-1 under the Exchange Act³ (“Regulation Best Interest”). In MSRB Notice 2020-13 (the “Notice”), the MSRB announced the approval of harmonization of the MSRB rules with Regulation Best Interest. The Notice stated, “Regulation Best Interest was adopted to establish a new standard of conduct for broker-dealers and the natural person associated persons of a broker-dealer (collectively, “broker-dealers”) when they make a recommendation to a *retail* customer, defined generally as a natural person or the legal representative of such person, who receives and uses a

¹ SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry’s nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

² Exchange Act Release No. 89154 (June 25, 2020) (File No. SR-MSRB-2020-02).

³ 17 CFR 240.15l-1.

recommendation from a broker-dealer primarily for personal, family, or household purposes, of any securities transaction or investment strategy involving securities (emphasis added).⁴ There was no stated intent in Regulation Best Interest to change standards related to recommendations to institutional or clients other than retail customers who are natural persons.

The amendment to Rule G-19 eliminated the language stricken below (the “Control Requirement”) from clause (c) of Supplemental Material .05 (the “Quantitative Suitability Requirement”). There are also corresponding amendments to Rules G-8, 9, 20 and 48. The suitability exemption afforded to sophisticated municipal market professionals (“SMMPs”) as provided by Rule G-48(c) does not apply to clause (c) of the Supplemental Material .05. Some SIFMA members believe that as a result of removal of the language stricken below in the Supplemental material, the Quantitative Suitability Requirement may now be applicable to SMMPs with non-discretionary accounts, as Rule G-48 only exempts the customer specific suitability requirement. Section (c) of Supplemental Material .05 was amended to read:

(c) Quantitative suitability requires a broker, dealer or municipal securities dealer ~~who has actual or de facto control over a customer account~~ to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in Rule G-19. No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a broker, dealer or municipal securities dealer has violated the quantitative suitability obligation.

Our concern relates specifically to this elimination of the Control Requirement language in Rule G-19 from clause (c) of Supplemental Material .05 relating to the Quantitative Suitability Requirement exemption for SMMPs. We note that on page 6 of MSRB Notice 2020-13, there is a reference to natural person SMMPs, and feel this reference is consistent with the notion that the intended amendments were only to change the standard for SMMPs who are natural person. SIFMA members feel strongly that the Quantitative Suitability Requirement in Rule G-19 should be clarified, and interpreted as applicable only to natural person SMMPs, but not to institutional SMMPs. Extending the Quantitative Suitability Requirement to all SMMPs would be unduly costly and burdensome and would does not harmonize the MSRB rules with Regulation Best Interest. Regulation Best Interest has changed many aspects of the relationship between broker dealers and their retail customers. Extending Regulation Best Interest to also include institutional and other non-natural persons SMMPs would necessarily alter those relationships as well, in costly and fundamental ways, and exceed the intended scope of the rule changes. SIFMA and its members urge the MSRB to clarify that the Quantitative Suitability Requirement in Rule G-19 does not apply to SMMPs who are not natural persons.

⁴ MSRB Notice 2020-13.

Although SIFMA recognizes that the MSRB's goal was harmonization between FINRA and MSRB with the Reg BI and quantitative suitability amendments, SIFMA believes that it is important to analyze the differences between how MSRB treats SMMPs in Rule G-30 versus how FINRA treats exempt institutional investors ("EII") in FINRA 2111 Supplementary Material: .07.

There are a number of areas where MSRB currently treats SMMPs differently than FINRA treats EIIs. SIFMA acknowledges that MSRB exempts SMMPs from G-19 customer-specific suitability, and FINRA also exempts EIIs from FINRA 2111 customer-specific suitability. However, this is where the similarities end. MSRB also exempts SMMPs from the application of its "best execution" rule standards; while FINRA does not exempt EIIs from application of its "best execution" rule standards. MSRB also exempts SMMPs from the application of its fair and reasonable pricing standards in G-30 in certain circumstances, while FINRA does not exempt EIIs from application of its similar fair prices and commissions rule in FINRA 2121.

Further, the MSRB has recently proposed to treat SMMPs differently from non-SMMPs in the mailing of the G-10 annual notice. This is yet another difference in treatment that SIFMA supports.

The MSRB has a long history of treating SMMPs differently from non-SMMPs, based on a reasoned recognition of the differences between these two investor classes and the relative protections that should be afforded to both. SIFMA is requesting MSRB to make another reasoned departure in how it treats SMMPs from how FINRA treats EIIs with respect to the Quantitative Suitability Requirement; and how it treats SMMPs vs how it treats non-SMMPs. Just as MSRB has determined that SMMPs do not need the protections of its "best execution" standards despite the fact that FINRA has not taken the same position for EIIs, we are asking MSRB to also determine that SMMPs do not need the protections of the quantitative suitability standards that became effective with the recent amendments to Rule G-19, even though FINRA may not take the same position. There is already precedent for MSRB to do so, and for the same reason that MSRB has determined to treat SMMPs differently from how it treats non-SMMPs as noted above, it should do so for quantitative suitability as well.

Thank you for considering SIFMA's comments. If a fuller discussion of our comments would be helpful, I can be reached at (212) 313-1130.

Sincerely,

A handwritten signature in black ink, appearing to be 'L. Norwood', written over a faint, light-colored signature line.

Leslie M. Norwood
Managing Director
and Associate General Counsel

cc: ***Municipal Securities Rulemaking Board***
Gail Marshall, Chief Regulatory Officer
David Hodapp, Director, Market Regulation

Rule G-19: Suitability of Recommendations and Transactions

A broker, dealer or municipal securities dealer must have a reasonable basis to believe that a recommended transaction or investment strategy involving a municipal security or municipal securities is suitable for the customer, based on the information obtained through the reasonable diligence of the broker, dealer or municipal securities dealer to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the broker, dealer or municipal securities dealer in connection with such recommendation.

This rule shall not apply to recommendations subject to Regulation Best Interest, Rule 15l-1 under the Act ("Regulation Best Interest"). When making recommendations of securities transactions or investment strategies involving a municipal security or municipal securities to a retail customer, a bank dealer shall comply with Regulation Best Interest.

Supplementary Material No change.

Rule G-48: Transactions with Sophisticated Municipal Market Professionals

A broker, dealer, or municipal securities dealer's obligations to a customer that it reasonably concludes is a Sophisticated Municipal Market Professional, or SMMP, as defined in Rule D-15, shall be modified as follows:

(a) - (b) No change.

(c) *Suitability*. When making a recommendation subject to Rule G-19 and not Regulation Best Interest, Rule 15l-1 under the Act, a broker, dealer, or municipal securities dealer shall not have any obligation under Rule G-19 to perform either (i) a customer-specific suitability analysis or (ii), unless the broker, dealer, or municipal securities dealer has actual control or de facto control of the SMMP's account, a quantitative suitability analysis.

(d) – (f) No change.