

### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. In terms of inter-market competition, the Exchange notes that it operates in a highly competitive market in which market participants can readily favor competing venues if they deem fee levels at a particular venue to be excessive, or rebate opportunities available at other venues to be more favorable. In such an environment, the Exchange must continually adjust its fees to remain competitive with other exchanges and with alternative trading systems that have been exempted from compliance with the statutory standards applicable to exchanges. Because competitors are free to modify their own fees in response and because market participants may readily adjust their order routing practices, the Exchange believes that the degree to which fee changes in this market may impose any burden on competition is extremely limited.

In this instance, the proposed change to fees assessed to Participants for execution of securities does not impose a burden on competition because the Exchange's execution services are completely voluntary and subject to extensive competition both from other exchanges and from off-exchange venues.

#### Non-NOM Market Maker Penny Pilot Options Fee for Removing Liquidity

The Exchange's proposal to decrease the Non-NOM Market Maker Fee for Removing Liquidity in Penny Pilot Options from \$0.55 to \$0.50 per contract for options overlying EEM, GLD, IWM, QQQ, and SPY does not impose an undue burden on intra-market competition because the Exchange will assess all Participants the same Fee for Removing Liquidity in Penny Pilot Options.

In sum, if the changes proposed herein are unattractive to market participants, it is likely that the Exchange will lose market share as a result. Accordingly, the Exchange does not believe that the proposed change will impair the ability of Participants or competing order execution venues to maintain their competitive standing in the financial markets.

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

No written comments were either solicited or received.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act.<sup>12</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) Necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or 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](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2015-155 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090. All submissions should refer to File Number SR-NASDAQ-2015-155. 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 Web site (<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 Web site 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 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASDAQ-2015-155 and should be submitted on or before January 20, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

**Brent J. Fields,**  
*Secretary.*

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## **SECURITIES AND EXCHANGE COMMISSION**

**[Release No. 34-76753; File No. SR-MSRB-2015-03]**

### **Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1 and Amendment No. 2, Consisting of Proposed New Rule G-42, on Duties of Non-Solicitor Municipal Advisors, and Proposed Amendments to Rule G-8, on Books and Records To Be Made by Brokers, Dealers, Municipal Securities Dealers, and Municipal Advisors**

December 23, 2015.

#### **I. Introduction**

On April 24, 2015, the Municipal Securities Rulemaking Board ("MSRB") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change consisting of proposed new Rule G-42, on duties of non-solicitor municipal advisors, and proposed amendments to Rule G-8, on books and records to be made by brokers, dealers, municipal securities dealers, and

<sup>13</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>12</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

municipal advisors. The proposed rule change was published for comment in the **Federal Register** on May 8, 2015.<sup>3</sup> The Commission received fifteen comment letters on the proposal.<sup>4</sup> On June 16, 2015, the MSRB granted an extension of time for the Commission to act on the filing until August 6, 2015. On August 6, 2015, the Commission issued an order instituting proceedings (“OIP”) under Section 19(b)(2)(B) of the Act<sup>5</sup> to determine whether to approve or disapprove the proposed rule change.<sup>6</sup> On August 12, 2015, the MSRB responded to the comments<sup>7</sup> and filed Amendment No. 1 to the proposed rule change.<sup>8</sup> The Commission published notice of Amendment No. 1 on August 25, 2015.<sup>9</sup> In response to the OIP or Amendment No. 1, the Commission

received 13 comment letters.<sup>10</sup> On October 28, 2015, the MSRB granted an extension of time for the Commission to act on the filing until January 3, 2016. On November 9, 2015, the MSRB filed Amendment No. 2 to the proposed rule change.<sup>11</sup> The Commission published notice of Amendment No. 2 on November 17, 2015,<sup>12</sup> and the Commission received seven comment letters in response to Amendment No. 2.<sup>13</sup> On December 16, 2015, the MSRB submitted a response to the comments received on the OIP, Amendment No. 1 and Amendment No. 2.<sup>14</sup> This order approves the proposed rule change, as modified by Amendment No. 1 and Amendment No. 2.

## II. Description of the Proposed Rule Change

As described more fully in the Proposing Release, as modified by Amendment No. 1 and Amendment No.

2, the MSRB is proposing to adopt new Rule G–42, on duties of non-solicitor municipal advisors and proposed amendments to Rule G–8, on books and records to be made by brokers, dealers, municipal securities dealers, and municipal advisors (the “proposed rule change”).

### *Proposed Rule G–42*

Proposed Rule G–42 would establish the core standards of conduct and duties of municipal advisors when engaging in municipal advisory activities, other than municipal advisory solicitation activities (“municipal advisors”). In summary, the core provisions of Proposed Rule G–42 would:

- Establish certain standards of conduct consistent with the fiduciary duty owed by a municipal advisor to its municipal entity clients, which includes a duty of care and of loyalty;
  - Establish the standard of care owed by a municipal advisor to its obligated person clients;
  - Require the full and fair disclosure, in writing, of all material conflicts of interest and legal or disciplinary events that are material to a client’s evaluation of a municipal advisor;
  - Require the documentation of the municipal advisory relationship, specifying certain aspects of the relationship that must be included in the documentation;
  - Require that recommendations made by a municipal advisor are suitable for its clients, or that it determine the suitability of recommendations made by third parties when appropriate; and
  - Specifically prohibit a municipal advisor from engaging in certain activities, including, in summary:
    - Receiving excessive compensation;
    - delivering inaccurate invoices for fees or expenses;
    - making false or misleading representations about the municipal advisor’s resources, capacity or knowledge;
    - participating in certain fee-splitting arrangements with underwriters;
    - participating in any undisclosed fee-splitting arrangements with providers of investments or services to a municipal entity or obligated person client of the municipal advisor;
    - making payments for the purpose of obtaining or retaining an engagement to perform municipal advisory activities, with limited exceptions; and
    - entering into certain principal transactions with the municipal advisor’s municipal entity clients, within limited exceptions.
- In addition, the proposed rule change would define key terms used in

<sup>3</sup> Exchange Act Release No. 74860 (May 4, 2015), 80 FR 26752 (May 8, 2015) (“Proposing Release”). The comment period closed on May 29, 2015.

<sup>4</sup> See Letters to Secretary, Commission, from Dustin McDonald, Director, Federal Liaison Center, Government Finance Officers Association (“GFOA”), dated May 22, 2015; Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (“SIFMA”), dated May 28, 2015; Cristeena Naser, Vice President, Center for Securities, Trust & Investments, American Bankers Association (“ABA”), dated May 29, 2015; Terri Heaton, President, National Association of Municipal Advisors (“NAMA”), dated May 29, 2015; Hill A. Feinberg, Chairman and Chief Executive Officer and Michael Bartolotta, Vice Chairman, First Southwest Company (“First Southwest”), dated May 29, 2015; Guy E. Yandel, EVP and Head of Public Finance, et al., George K. Baum & Company (“GKB”), dated May 29, 2015; David T. Bellaire, Executive Vice President and General Counsel, Financial Services Institute (“FSI”), dated May 29, 2015; Robert J. McCarthy, Director of Regulatory Policy, Wells Fargo Advisors LLC, (“Wells Fargo”), dated May 29, 2015; Tamara K. Salmon, Associate General Counsel, Investment Company Institute (“ICI”), dated May 29, 2015; W. David Hemingway, Executive Vice President, Zions First National Bank (“Zions”), dated May 29, 2015; Lindsey K. Bell, Millar Jiles, LLP (“Millar Jiles”), dated May 29, 2015; Michael Nicholas, Chief Executive Officer, Bond Dealers of America (“BDA”), dated May 29, 2015; Joy A. Howard, WM Financial Strategies (“WM Financial”), dated May 29, 2015; Leo Karwejna, Managing Director, Chief Compliance Officer, The PFM Group (“PFM”), dated May 29, 2015; and Dustin T. McDonald, Director, Federal Liaison Center, GFOA, dated June 15, 2015. Staff from the Office of Municipal Securities discussed the proposed rule change with representatives from SIFMA on May 21, 2015, representatives from NAMA on June 3, 2015 and representatives from BDA on June 17, 2015.

<sup>5</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>6</sup> See Exchange Act Release No. 75628 (August 6, 2015), 80 FR 48355 (August 12, 2015). The comment period closed on September 11, 2015.

<sup>7</sup> See Letter from Michael L. Post, MSRB, to Secretary, SEC, dated August 12, 2015 (“August Response Letter”), available at <http://www.sec.gov/comments/sr-msrb-2015-03/msrb201503-19.pdf>.

<sup>8</sup> See Letter from Michael L. Post, MSRB, to Secretary, SEC, dated August 12, 2015, available at <http://www.sec.gov/comments/sr-msrb-2015-03/msrb201503-20.pdf>.

<sup>9</sup> See Exchange Act Release No. 75737 (August 19, 2015), 80 FR 51645 (August 25, 2015). The comment period closed on September 11, 2015.

<sup>10</sup> See letters from Michael Nicholas, Chief Executive Officer, BDA, dated September 11, 2015 and November 4, 2015; John C. Melton, Sr., Executive Vice President, Coastal Securities (“Coastal Securities”), dated September 11, 2015; Jeff White, Principal, Columbia Capital Management, LLC (“Columbia Capital”), dated September 10, 2015; Joshua Cooperman, Cooperman Associates (“Cooperman”), dated September 9, 2015; David T. Bellaire, Executive Vice President & General Counsel, FSI, dated September 11, 2015; Dustin McDonald, Director, Federal Liaison Center, GFOA, dated September 14, 2015; Tamara K. Salmon, Associate General Counsel, ICI, dated September 11, 2015; Lindsey K. Bell, Millar Jiles, dated September 11, 2015; Terri Heaton, President, NAMA, dated September 11, 2015; Leslie M. Norwood, Managing Director and Associate General Counsel, SIFMA, dated September 11, 2015; Joy A. Howard, Principal, WM Financial, dated September 11, 2015; and W. David Hemingway, Executive Vice President, Zions, dated September 10, 2015. Staff from the Office of Municipal Securities discussed the proposed rule change with representatives from BDA on October 5, 2015 and representatives from SIFMA on October 15, 2015.

<sup>11</sup> See Letter from Michael L. Post, MSRB, to Secretary, SEC, dated November 9, 2015, available at <http://www.sec.gov/comments/sr-msrb-2015-03/msrb201503-36.pdf>.

<sup>12</sup> See Exchange Act Release No. 76420 (November 10, 2015), 80 FR 71858 (November 17, 2015). The comment period closed on December 1, 2015.

<sup>13</sup> See Letters to Secretary, Commission, from Michael Nicholas, Chief Executive Officer, BDA, dated December 1, 2015; David T. Bellaire, Executive Vice President and General Counsel, FSI, dated December 1, 2015; Dustin McDonald, Director, Federal Liaison Center, GFOA, dated December 1, 2015; Tamara K. Salmon, Associate General Counsel, ICI, dated December 1, 2015; Terri Heaton, President, NAMA, dated December 7, 2015; Leslie M. Norwood, Managing Director and Associate General Counsel, SIFMA, dated December 1, 2015; and Spencer Wright dated December 16, 2015.

<sup>14</sup> See Letter to Secretary, Commission, from Michael L. Post, MSRB, dated December 16, 2015 (the “December Response Letter” and, together with the August Response Letter, the “MSRB Response Letters”), available at <http://www.sec.gov/comments/sr-msrb-2015-03/msrb201503-44.pdf>.

Proposed Rule G-42 and provide supplementary material. The supplementary material would provide additional guidance on the core concepts in the proposed rule, such as the duty of care, the duty of loyalty, the impact of client action that is independent of or contrary to the advice of a municipal advisor, suitability of recommendations and “Know Your Client” obligations; provide context for issues such as the scope of an engagement, conflicts of interest disclosures, excessive compensation, and the applicability of the proposed rule change to 529 college savings plans (“529 plans”) and other municipal entities; provide guidance regarding the definition of “principal transaction;” recognize the continued applicability of state and other laws regarding fiduciary and other duties owed by municipal advisors; include information regarding requirements that must be met for a municipal advisor to be relieved of certain provisions of Proposed Rule G-42 in instances when it inadvertently engages in municipal advisory activities; and, finally, provide a narrow exception to the proposed prohibition on certain principal transactions with municipal entity clients for transactions in specified types of fixed income securities.

#### Standards of Conduct

Section (a) of Proposed Rule G-42 would establish the core standards of conduct and duties applicable to municipal advisors. Subsection (a)(i) of Proposed Rule G-42 would provide that each municipal advisor in the conduct of its municipal advisory activities for an obligated person client is subject to a duty of care. Subsection (a)(ii) would provide that each municipal advisor in the conduct of its municipal advisory activities for a municipal entity client is subject to a fiduciary duty, which includes a duty of loyalty and a duty of care.

Proposed supplementary material would provide guidance on the duty of care and the duty of loyalty. Paragraph .01 of the Supplementary Material would describe the duty of care to require, without limitation, a municipal advisor to: (1) Exercise due care in performing its municipal advisory activities; (2) possess the degree of knowledge and expertise needed to provide the municipal entity or obligated person client with informed advice; (3) make a reasonable inquiry as to the facts that are relevant to a client’s determination as to whether to proceed with a course of action or that form the basis for any advice provided to the client; and (4) undertake a reasonable

investigation to determine that the municipal advisor is not basing any recommendation on materially inaccurate or incomplete information. The duty of care that would be established in section (a) of Proposed Rule G-42 would also require the municipal advisor to have a reasonable basis for: any advice provided to or on behalf of a client; any representations made in a certificate that it signs that will be reasonably foreseeably relied upon by the client, any other party involved in the municipal securities transaction or municipal financial product, or investors in the municipal entity client’s securities or securities secured by payments from an obligated person client; and, any information provided to the client or other parties involved in the municipal securities transaction in connection with the preparation of an official statement for any issue of municipal securities as to which the advisor is advising.

Paragraph .02 of the Supplementary Material would describe the duty of loyalty to require, without limitation, a municipal advisor, when engaging in municipal advisory activities for a municipal entity, to deal honestly and with the utmost good faith with the client and act in the client’s best interests without regard to the financial or other interests of the municipal advisor. Paragraph .02 would also provide that the duty of loyalty would preclude a municipal advisor from engaging in municipal advisory activities with a municipal entity client if it cannot manage or mitigate its conflicts of interest in a manner that will permit it to act in the municipal entity’s best interests.

Paragraph .03 of the Supplementary Material would specify that a municipal advisor is not required to disengage from a municipal advisory relationship if a municipal entity client or an obligated person client elects a course of action that is independent of or contrary to advice provided by the municipal advisor.

Paragraph .04 of the Supplementary Material would specify that a municipal advisor could limit the scope of the municipal advisory activities to be performed to certain specified activities or services if requested or expressly consented to by the client, but could not alter the standards of conduct or impose limitations on any of the duties prescribed by Proposed Rule G-42. Paragraph .04 would provide that, if a municipal advisor engages in a course of conduct that is inconsistent with the mutually agreed limitations to the scope of the engagement, it may result in

negating the effectiveness of the limitations.

Paragraph .08 of the Supplementary Material would state, as a general matter, that, municipal advisors may be subject to fiduciary or other duties under state or other laws and nothing in Proposed Rule G-42 would supersede any more restrictive provision of state or other laws applicable to municipal advisory activities.

#### Disclosure of Conflicts of Interest and Other Information

Section (b) of Proposed Rule G-42 would require a municipal advisor to fully and fairly disclose to its client in writing all material conflicts of interest, and to do so prior to or upon engaging in municipal advisory activities. The provision would set forth a non-exhaustive list of scenarios under which a material conflict of interest would arise or be deemed to exist and that would require a municipal advisor to provide written disclosures to its client. Subsections (b)(i)(A) through (E) would provide specific scenarios that give rise to conflicts of interest that would be deemed to be material and require proper disclosure to a municipal advisor’s client. Under the proposed rule change, a material conflict of interest would always include: Any affiliate of the municipal advisor that provides any advice, service or product to or on behalf of the client that is directly related to the municipal advisory activities to be performed by the disclosing municipal advisor; any payments made by the municipal advisor, directly or indirectly, to obtain or retain an engagement to perform municipal advisory activities for the client; any payments received by the municipal advisor from a third party to enlist the municipal advisor’s recommendations to the client of its services, any municipal securities transaction or any municipal financial product; any fee-splitting arrangements involving the municipal advisor and any provider of investments or services to the client; and any conflicts of interest arising from compensation for municipal advisory activities to be performed that is contingent on the size or closing of any transaction as to which the municipal advisor is providing advice. Subsection (b)(i)(F) would require municipal advisors to disclose any other actual or potential conflicts of interest, of which the municipal advisor is aware after reasonable inquiry, that could reasonably be anticipated to impair its ability to provide advice to or on behalf of its client in accordance with the applicable standards of

conduct established by section (a) of the proposed rule.

Under subsection (b)(i), if a municipal advisor were to conclude, based on the exercise of reasonable diligence, that it had no known material conflicts of interest, the municipal advisor would be required to provide a written statement to the client to that effect.

Subsection (b)(ii) would require disclosure of any legal or disciplinary event that would be material to the client's evaluation of the municipal advisor or the integrity of its management or advisory personnel. A municipal advisor would be permitted to fulfill this disclosure obligation by identifying the specific type of event and specifically referring the client to the relevant portions of the municipal advisor's most recent SEC Forms MA or MA-I<sup>15</sup> filed with the Commission, if the municipal advisor provides detailed information specifying where the client could access such forms electronically.

Paragraph .05 of the Supplementary Material would provide that the required conflicts of interest disclosures must be sufficiently detailed to inform the client of the nature, implications and potential consequences of each conflict and must include an explanation of how the municipal advisor addresses or intends to manage or mitigate each conflict.<sup>16</sup>

Paragraph .07 of the Supplementary Material would provide that a municipal advisor that inadvertently engages in municipal advisory activities but does not intend to continue the municipal advisory activities or enter into a municipal advisory relationship<sup>17</sup> would not be required to comply with sections (b) and (c) of

<sup>15</sup> See 17 CFR 249.1300 (SEC Form MA); 17 CFR 249.1310 (SEC Form MA-I).

<sup>16</sup> The MSRB believes that this requirement is analogous to the requirement of Form ADV (17 CFR 279.1) under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 *et seq.*) that obligates an investment adviser to describe how it addresses certain conflicts of interest with its clients. See, e.g., Form ADV, Part 2, Item 5.E.1 of Part 2A (requiring an investment adviser to describe how it will address conflicts of interest that arise in regards to fees and compensation it receives, including the investment adviser's procedures for disclosing the conflicts of interest with its client). See also Form ADV, Part 2A Items 6, 10, 11, 14 and 17.

<sup>17</sup> Under subsection (f)(vi) of Proposed Rule G-42, the MSRB notes that a municipal advisory relationship would be deemed to exist when a municipal advisor enters into an agreement to engage in municipal advisory activities for a municipal entity or obligated person, and would be deemed to have ended on the earlier of (i) the date on which the municipal advisory relationship has terminated pursuant to the terms of the documentation of the municipal advisory relationship required in section (c) of Proposed Rule G-42 or (ii) the date on which the municipal advisor withdraws from the municipal advisory relationship.

Proposed Rule G-42 (relating to disclosure of conflicts of interest and documentation of the relationship), if the municipal advisor takes the prescribed actions listed under paragraph .07 promptly after it discovers its provision of inadvertent advice. The municipal advisor would be required to provide to the client a dated document that would include: A disclaimer stating that the municipal advisor did not intend to provide advice and that, effective immediately, the municipal advisor has ceased engaging in municipal advisory activities with respect to that client in regard to all transactions and municipal financial products as to which advice was inadvertently provided; a notification that the client should be aware that the municipal advisor has not provided the disclosure of material conflicts of interest and other information required under section (b); an identification of all of the advice that was inadvertently provided, based on a reasonable investigation; and a request that the municipal entity or obligated person acknowledge receipt of the document. The municipal advisor also would be required to conduct a review of its supervisory and compliance policies and procedures to ensure that they are reasonably designed to prevent inadvertently providing advice to municipal entities and obligated persons. The final sentence of paragraph .07 of the Supplementary Material would also clarify that the satisfaction of the requirements of paragraph .07 would have no effect on the applicability of any provisions of Proposed Rule G-42 other than sections (b) and (c), or any other legal requirements applicable to municipal advisory activities.

#### Documentation of the Municipal Advisory Relationship

Section (c) of Proposed Rule G-42 would require each municipal advisor to evidence each of its municipal advisory relationships by a writing, or writings created and delivered to the municipal entity or obligated person client prior to, upon or promptly after the establishment of the municipal advisory relationship. The documentation would be required to be dated and include, at a minimum:<sup>18</sup>

- The form and basis of direct or indirect compensation, if any, for the municipal advisory activities to be

<sup>18</sup> While no acknowledgement from the client of its receipt of the documentation would be required, the MSRB notes that a municipal advisor must, as part of the duty of care it owes its client, reasonably believe that the documentation was received by its client.

performed, as provided in proposed subsection (c)(i);

- the information required to be disclosed in proposed section (b), including the disclosures of conflicts of interest, as provided in proposed subsection (c)(ii);

- a description of the specific type of information regarding legal and disciplinary events requested by the Commission on SEC Form MA and SEC Form MA-I, as provided in proposed subsection (c)(iii), and detailed information specifying where the client may electronically access the municipal advisor's most recent Form MA and each most recent Form MA-I filed with the Commission;<sup>19</sup>

- the date of the last material change to the legal or disciplinary event disclosures on any SEC Forms MA or MA-I filed with the Commission by the municipal advisor and a brief explanation of the basis for the materiality of the change or addition, as provided in proposed subsection (c)(iv);

- the scope of the municipal advisory activities to be performed and any limitations on the scope of the engagement, as provided in proposed subsection (c)(v);

- the date, triggering event, or means for the termination of the municipal advisory relationship, or, if none, a statement that there is none, as provided in proposed subsection (c)(vi); and

- any terms relating to withdrawal from the municipal advisory relationship, as provided in proposed subsection (c)(vii).

Paragraph .06 of the Supplementary Material would require municipal advisors to promptly amend or supplement the writing(s) required by section (c) during the term of the municipal advisory relationship as necessary to reflect any material changes or additions in the required information. Paragraph .06 would also provide that a municipal advisor would not be required to provide the disclosure of conflicts of interest and other information required under proposed section (c)(ii) if the municipal advisor previously fully complied with the requirements of proposed section (b) to disclose such information and proposed subsection (c)(ii) would not require the disclosure of any materially different information than that previously disclosed to the client.

<sup>19</sup> The MSRB notes that compliance with this requirement could be achieved in the same manner, and (so long as done upon or prior to engaging in municipal advisory activities for the client) concurrently with providing to the client the information required under proposed subsection (b)(ii).

## Recommendations and Review of Recommendations of Other Parties

Section (d) of Proposed Rule G-42 would provide that a municipal advisor must not recommend that its client enter into any municipal securities transaction or municipal financial product unless the municipal advisor has a reasonable basis to believe, based on the information obtained through the reasonable diligence of the municipal advisor, that the recommended transaction or product is suitable for the client. Proposed section (d) also contemplates that a municipal advisor may be requested by the client to review and determine the suitability of a recommendation made by a third party to the client. If a client were to request this type of review, and such review were within the scope of the engagement, the municipal advisor's determination regarding the suitability of the third-party's recommendation regarding a municipal securities transaction or municipal financial product would be subject to the same reasonable diligence standard—requiring the municipal advisor to obtain relevant information through the exercise of reasonable diligence.

As to both types of review, the municipal advisor would be required under proposed section (d) to inform its municipal entity or obligated person client of its evaluation of the material risks, potential benefits, structure and other characteristics of the recommended municipal securities transaction or municipal financial product; the basis upon which the advisor reasonably believes the recommended transaction or product is, or (as may be applicable in the case of a review of a recommendation) is not, suitable for the client; and whether the municipal advisor has investigated or considered other reasonably feasible alternatives to the recommended municipal securities transaction or municipal financial product that might also or alternatively serve the client's objectives.

Paragraph .09 of the Supplementary Material would provide guidance related to a municipal advisor's suitability obligations. Under this provision, a municipal advisor's determination of whether a municipal securities transaction or municipal financial product is suitable for its client must be based on numerous factors, as applicable to the particular type of client, including, but not limited to: The client's financial situation and needs, objectives, tax status, risk tolerance, liquidity needs, experience with municipal securities transactions

or municipal financial products generally or of the type and complexity being recommended, financial capacity to withstand changes in market conditions during the term of the municipal financial product or the period that municipal securities to be issued are reasonably expected to be outstanding, and any other material information known by the municipal advisor about the client and the municipal securities transaction or municipal financial product, after the municipal advisor has conducted a reasonable inquiry.

In connection with a municipal advisor's obligation to determine the suitability of a municipal securities transaction or a municipal financial product for a client, which should take into account its knowledge of the client, paragraph .10 of the Supplementary Material would require a municipal advisor to know its client. The obligation to know the client would require a municipal advisor to use reasonable diligence to know and retain essential facts concerning the client and the authority of each person acting on behalf of the client, and is similar to requirements in other regulatory regimes.<sup>20</sup> The facts "essential" to knowing one's client would include those required to effectively service the municipal advisory relationship with the client; act in accordance with any special directions from the client; understand the authority of each person acting on behalf of the client; and comply with applicable laws, rules and regulations.

### Specified Prohibitions

Subsection (e)(i)(A) would prohibit a municipal advisor from receiving compensation from its client that is excessive in relation to the municipal advisory activities actually performed for the client. Paragraph .11 of the Supplementary Material would provide additional guidance on how compensation would be determined to be excessive. Included in paragraph .11

<sup>20</sup> The MSRB notes that similar requirements apply to brokers and dealers under FINRA Rule 2090 (Know Your Customer) and swap dealers under Commodity Futures Trading Commission ("CFTC") Rule 402(b) (General Provisions: Know Your Counterparty), 17 CFR 23.402(b), found in CFTC Rules, Ch. I, Pt. 23, Subpt. H (Business Conduct Standards for Swap Dealers and Major Swap Participants Dealing with Counterparties, including Special Entities) (17 CFR 23.400 *et seq.*). Notably, the CFTC's rule applies to dealings with special entity clients, defined to include states, state agencies, cities, counties, municipalities, other political subdivisions of a State, or any instrumentality, department, or a corporation of or established by a State or political subdivision of a State. See CFTC Rule 401(c) (defining "special entity") (17 CFR 23.401(c)).

are several factors that would be considered when evaluating the reasonableness of a municipal advisor's compensation relative to the nature of the municipal advisory activities performed, including, but not limited to: The municipal advisor's expertise, the complexity of the municipal securities transaction or municipal financial product, whether the fee is contingent upon the closing of the municipal securities transaction or municipal financial product, the length of time spent on the engagement and whether the municipal advisor is paying any other relevant costs related to the municipal securities transaction or municipal financial product.

Subsection (e)(i)(B) would prohibit municipal advisors from delivering an invoice for fees or expenses for municipal advisory activities that is materially inaccurate in its reflection of the activities actually performed or the personnel that actually performed those activities.

Subsection (e)(i)(C) would prohibit a municipal advisor from making any representation or submitting any information that the municipal advisor knows or should know is either materially false or materially misleading due to the omission of a material fact, about its capacity, resources or knowledge in response to requests for proposals or in oral presentations to a client or prospective client for the purpose of obtaining or retaining an engagement to perform municipal advisory activities.

Subsection (e)(i)(D) would prohibit municipal advisors from making or participating in two types of fee-splitting arrangements: (1) Any fee-splitting arrangement with an underwriter on any municipal securities transaction as to which the municipal advisor has provided or is providing advice; and (2) any undisclosed fee-splitting arrangement with providers of investments or services to a municipal entity or obligated person client of the municipal advisor.

Subsection (e)(i)(E) would, generally, prohibit a municipal advisor from making payments for the purpose of obtaining or retaining an engagement to perform municipal advisory activities. However, the provision contains three exceptions. The prohibition would not apply to: (1) Payments to an affiliate of the municipal advisor for a direct or indirect communication with a municipal entity or obligated person on behalf of the municipal advisor where such communication is made for the purpose of obtaining or retaining an engagement to perform municipal advisory activities; (2) reasonable fees

paid to another municipal advisor registered as such with the Commission and MSRB for making such a communication as described in subsection (e)(i)(E)(1); and (3) payments that are permissible “normal business dealings” as described in MSRB Rule G–20.

#### Principal Transactions

Subsection (e)(ii) of Proposed Rule G–42 would, subject to the exception provided in paragraph .14 of the Supplementary Material, prohibit a municipal advisor to a municipal entity, and any affiliate of such municipal advisor, from engaging with the municipal entity client in a principal transaction that is the same, or directly related to the, issue of municipal securities or municipal financial product as to which the municipal advisor is providing or has provided advice to the municipal entity client. The ban on principal transactions would apply only with respect to clients that are municipal entities. The ban would not apply to principal transactions between a municipal advisor (or an affiliate of the municipal advisor) and the municipal advisor’s obligated person clients. Although such transactions would not be prohibited, the MSRB notes that all municipal advisors, including those engaging in municipal advisory activities for obligated person clients, are currently subject to the MSRB’s fundamental fair-practice rule, Rule G–17.

Paragraph .08 of the Supplementary Material would provide an exception to the ban on principal transactions in subsection (e)(ii) in order to avoid a possible conflict with existing MSRB Rule G–23, on activities of financial advisors. Specifically, the ban in subsection (e)(ii) would not apply to an acquisition as principal, either alone or as a participant in a syndicate or other similar account formed for the purpose of purchasing, directly or indirectly, from an issuer all or any portion of an issuance of municipal securities on the basis that the municipal advisor provided advice as to the issuance, because such a transaction is the type of transaction that is addressed, and, in certain circumstances, prohibited by Rule G–23.

For purposes of the prohibition in proposed subsection (e)(ii), subsection (f)(ix) would define the term “principal transaction” to mean “when acting as principal for one’s own account, a sale to or a purchase from the municipal entity client of any security or entrance into any derivative, guaranteed investment contract, or other similar financial product with the municipal

entity client.” Further, paragraph .13 of the Supplementary Material would clarify that the term “other similar financial product,” as used in subsection (f)(ix), would include a bank loan, but only if it is in an aggregate principal amount of \$1,000,000 or more and is economically equivalent to the purchase of one or more municipal securities.

Paragraph .14 of the Supplementary Material would provide an exception (the “Exception”) to the ban on principal transactions for transactions in specified fixed income securities. As provided in proposed section (a) of paragraph .14 of the Supplementary Material, a principal transaction could be excepted from the specified prohibition only if the municipal advisor also is a broker-dealer registered under Section 15 of the Exchange Act,<sup>21</sup> and each account for which the municipal advisor would be relying on the Exception is a brokerage account subject to the Exchange Act,<sup>22</sup> the rules thereunder, and the rules of the self-regulatory organization(s) of which the broker-dealer is a member. In addition, the municipal advisor could not exercise investment discretion (as defined in Section 3(a)(35) of the Exchange Act)<sup>23</sup> with respect to the account, unless granted by the municipal entity client on a temporary or limited basis.<sup>24</sup>

Under proposed section (b) of paragraph .14 of the Supplementary Material, neither the municipal advisor nor any affiliate of the municipal advisor may be providing, or have provided, advice to the municipal entity client as to an issue of municipal securities or a municipal financial product that is directly related to the principal transaction, except advice as to another principal transaction that also meets all the other requirements of proposed paragraph .14.

Proposed section (c) of paragraph .14 of the Supplementary Material would limit a municipal advisor’s principal transactions under the Exception to sales to or purchases from a municipal entity client of any U.S. Treasury security, agency debt security or corporate debt security. In addition, the proposed Exception would not be available for transactions involving municipal escrow investments as defined in Exchange Act Rule 15Ba1–

1(h)<sup>25</sup> because the MSRB believes that this is an area of heightened risk where, historically, significant abuses have occurred. The terms “U.S. Treasury security,” “agency debt security” and “corporate debt security,” and related terms, “agency,” “government-sponsored enterprise,” “money market instrument” and “securitized product” would be defined for purposes of proposed paragraphs .14 and .15 of the Supplementary Material in new proposed paragraph .15 of the Supplementary Material.

To comply with proposed section (d) of paragraph .14 of the Supplementary Material, a municipal advisor would have two options. Under the first option, which is set forth in proposed subsection (d)(1) of paragraph .14, a municipal advisor would be required, on a transaction-by-transaction basis, to disclose to the municipal entity client in writing before the completion of the principal transaction the capacity in which the municipal advisor is acting and obtain the consent of the client to such transaction. Consent would mean informed consent, and in order to make informed consent, the municipal advisor, consistent with its fiduciary duty, would be required to disclose specified information, including the price and other terms of the transaction, as well as the capacity in which the municipal advisor would be acting.<sup>26</sup> “Before completion” would mean either prior to execution of the transaction, or after execution but prior to the settlement of the transaction.<sup>27</sup>

Alternatively, a municipal advisor could comply with proposed subsection (d)(2) of paragraph .14 by meeting six requirements, as set forth in proposed paragraphs (d)(2)(A) through (F) of paragraph .14 and summarized below. First, under proposed paragraph (d)(2)(A), neither the municipal advisor nor any of its affiliates could be the issuer, or the underwriter (as defined in Exchange Act Rule 15c2–12(f)(8)),<sup>28</sup> of a security that is the subject of the principal transaction. Second, under proposed paragraph (d)(2)(B), the municipal advisor would be required to obtain from the municipal entity client an executed written, revocable consent that would prospectively authorize the municipal advisor directly or indirectly to act as principal for its own account in selling a security to or purchasing a security from the municipal entity

<sup>21</sup> 15 U.S.C. 78o.

<sup>22</sup> 15 U.S.C. 78a *et seq.*

<sup>23</sup> 15 U.S.C. 78(c)(a)(35).

<sup>24</sup> The MSRB notes that the proposed requirements are similar to those found in Advisers Act Rule 206(3)–T(a)(7) and (1), respectively. 17 CFR 275.206(3)–3T(a)(7) and (1).

<sup>25</sup> 17 CFR 240.15Ba1–1(h).

<sup>26</sup> See Amendment No. 2.

<sup>27</sup> These requirements are substantially similar to long-standing interpretive guidance regarding Advisers Act Section 206(3). 15 U.S.C. 80b–6(3).

<sup>28</sup> 17 CFR 240.15c2–12(f)(8).

client, so long as such written consent were obtained after written disclosure to the municipal entity client explaining: (i) The circumstances under which the municipal advisor directly or indirectly may engage in principal transactions; (ii) the nature and significance of conflicts with the municipal entity client's interests as a result of the transactions; and (iii) how the municipal advisor addresses those conflicts.

Third, under proposed paragraph (d)(2)(C), the municipal advisor, prior to the execution of each principal transaction, would be required to: (i) Inform the municipal entity client, orally or in writing, of the capacity in which it may act with respect to such transaction and (ii) obtain consent from the municipal entity client, orally or in writing, to act as principal for its own account with respect to such transaction.

Fourth, under proposed paragraph (d)(2)(D), a municipal advisor would be required to send a written confirmation at or before completion of each principal transaction that includes the information required by 17 CFR 240.10b-10 or MSRB Rule G-15, and a conspicuous, plain English statement informing the municipal entity client that the municipal advisor: (i) Disclosed to the client prior to the execution of the transaction that the municipal advisor may be acting in a principal capacity in connection with the transaction and the client authorized the transaction and (ii) sold the security to, or bought the security from, the client for its own account.

Fifth, under proposed paragraph (d)(2)(E), a municipal advisor would be required to send its municipal entity client, no less frequently than annually, written disclosure containing a list of all transactions that were executed in the client's account in reliance upon the Exception, and the date and price of the transactions.

Sixth, under proposed paragraph (d)(2)(F), each written disclosure would be required to include a conspicuous, plain English statement regarding the ability of the municipal entity client to revoke the prospective written consent to principal transactions without penalty at any time by written notice.

A municipal advisor's use and compliance with the requirements of the Exception would not be construed as relieving it in any way from acting in the best interests of its municipal entity client nor from any obligation that may be imposed by other applicable provisions of the federal securities laws and state law.

### Definitions

Section (f) of Proposed Rule G-42 would provide definitions of the terms "affiliate of the municipal advisor," "municipal advisory relationship," "official statement," and "principal transaction." Further, for several terms in Proposed Rule G-42 that have been previously defined by federal statute or SEC rules, proposed section (f) would, for purposes of Proposed Rule G-42, adopt the same meanings. These terms would include "advice;" "municipal advisor;" "municipal advisory activities;" "municipal entity;" and "obligated person."

### Applicability of Proposed Rule G-42 to 529 College Savings Plans and Other Municipal Fund Securities

Paragraph .12 of the Supplementary Material emphasizes the proposed rule's application to municipal advisors whose municipal advisory clients are sponsors or trustees of municipal fund securities.

### Proposed Amendments to Rule G-8

The proposed amendments to Rule G-8 would require each municipal advisor to make and keep a copy of any document created by the municipal advisor that was material to its review of a recommendation by another party or that memorializes its basis for any determination as to suitability.

## III. Summary of Comments Received and the MSRB's Response

As noted previously, the Commission received 15 comment letters in response to the Proposing Release, 13 comment letters in response to the OIP or Amendment No. 1 and seven comment letters in response to Amendment No. 2.<sup>29</sup> The MSRB responded to the comment letters received on the Proposing Release in its August Response Letter,<sup>30</sup> and the MSRB responded to the comment letters received on the OIP, Amendment No. 1 and Amendment No. 2 in its December Response Letter.<sup>31</sup>

### A. Standards of Conduct—Scope of Duties

In response to the Proposing Release, SIFMA stated that the addition of "without limitation" in Proposed Rule G-42(a)(ii) raises significant and unnecessary ambiguities, as a fiduciary duty is generally understood to encompass a duty of care and duty of loyalty.<sup>32</sup> It also stated that the language

"includes, but is not limited to" in paragraph .02 of the Supplementary Material was vague, and suggested that the MSRB specify what other duties are included. In response to the comment, the MSRB, in Amendment No. 1, eliminated the phrase "without limitation," in Proposed Rule G-42(a)(ii). However, the MSRB did not make the suggested change to paragraph .02 of the Supplementary Material because the MSRB stated its intent to make clear that the proposed rule change is not an exhaustive statement of all aspects of the duty of loyalty.<sup>33</sup>

### B. Duty of Care—Reasonable Investigation of Facts

In response to the Proposing Release, four commenters expressed concern regarding the duty of care standard, as expressed in paragraph .01 of the Supplementary Material, which requires municipal advisors to undertake "a reasonable investigation" to avoid basing recommendations on "materially inaccurate or incomplete information."<sup>34</sup> All four commenters argued that a municipal advisor should be permitted to assume that information beyond what is publicly available and is provided by the client is complete and accurate. ICI and SIFMA argued that this requirement was inconsistent with current regulatory regimes as other financial professionals are not required to investigate information provided by clients.<sup>35</sup> SIFMA expressed concern that this requirement would make a municipal advisor potentially liable to its client for that client's own misrepresentations.<sup>36</sup> ICI argued that in the context of 529 college savings plans, it is not uncommon for the municipal advisor that is acting as a plan sponsor to rely on its state partner to provide the advisor with the information necessary for the advisor to fulfill its obligations and duties to the plan.<sup>37</sup> In such circumstances, ICI argued, municipal advisors should be able to presume the states' representatives are providing materially accurate and complete information. GFOA supported the duty of care provisions generally but expressed concern that requiring a municipal advisor to investigate this information "may be excessive" and could lead to cost increases that could be passed on to the client.<sup>38</sup> Finally,

<sup>29</sup> See August Response Letter.

<sup>30</sup> See letters from ICI dated May 29, 2015; GFOA dated June 15, 2015; SIFMA dated May 28, 2015; and WM Financial dated May 29, 2015.

<sup>31</sup> See letters from ICI dated May 29, 2015 and SIFMA dated May 28, 2015.

<sup>32</sup> See SIFMA letter dated May 28, 2015.

<sup>33</sup> See ICI letter dated May 29, 2015.

<sup>34</sup> See GFOA letter dated June 15, 2015.

<sup>29</sup> See *supra* notes 4, 10 and 13.

<sup>30</sup> See August Response Letter.

<sup>31</sup> See December Response Letter.

<sup>32</sup> See SIFMA letter dated May 28, 2015.



NAMA requested the MSRB provide clarity by providing “non-exclusive explanatory examples of what constitutes a ‘reasonable inquiry as to the facts that are relevant to a client’s determination as to whether to proceed with a course of action.’”<sup>39</sup>

In its response to comments, the MSRB noted that it had previously responded to similar comments in the Proposing Release and that it had determined that the requirement would not result in an unreasonable and unnecessary burden for municipal advisors or their clients.<sup>40</sup> In response to Amendment No. 1 or the OIP, Columbia Capital, ICI, NAMA, SIFMA and WM Financial each expressed similar concerns regarding the same requirement.<sup>41</sup> In Columbia Capital’s view, the proposed requirement is unreasonable because it would hold a municipal advisor accountable if a municipal entity or obligated person fails to provide the municipal advisor pertinent non-public information that might have impacted its advice or recommendations.<sup>42</sup> ICI noted its consistent support of Proposed Rule G-42, but reiterated its objection to the requirement that a municipal advisor conduct a reasonable investigation of the veracity of the information provided by a municipal advisory client.<sup>43</sup> ICI stated its view that, to date, the MSRB has failed to provide any rationale, or “meaningful information” supporting the necessity of the requirement, or why such investigation is in the public interest. In addition, ICI stated that the MSRB has not provided sufficient economic analysis for this requirement. NAMA believed the proposed rule change does not provide adequate guidance as to what a “reasonable investigation” would require of a municipal advisor.<sup>44</sup> NAMA believed, without further clarity, examination for compliance with the proposed rule change by financial regulators “could lead to unsettling results.” SIFMA commented that the proposed obligation is “unnecessary, counterproductive, and inefficient.”<sup>45</sup> In addition, SIFMA believed that the requirement would impose unnecessary costs on municipal

advisor clients, who, in SIFMA’s opinion, would ultimately bear the financial burden of having their municipal advisor investigate facts already known to the client. ICI and SIFMA both pointed to other regulatory regimes and rules where, according to the commenters, regulated entities (e.g., broker-dealers, swap dealers and investment advisers) are not required to investigate information provided by clients.

WM Financial supported the requirement that a municipal advisor should conduct reasonable investigations of publicly available documentation and engage in discussions with the client such that the municipal advisor’s recommendations reflect what the advisor reasonably believes is in the customer’s best interest.<sup>46</sup> However, WM Financial commented that a municipal advisor should not be required to determine whether the information provided to it by its client is materially inaccurate or incomplete, and should be able to rely on publicly available documents as being true and accurate.

In response to Amendment No. 2, ICI reiterated the concerns regarding the Proposed Rule’s requirement that municipal advisors undertake a reasonable investigation of the accuracy and completeness of information on which a municipal advisor bases its recommendation.<sup>47</sup> ICI stated that Amendment No. 2, despite the amendment stating otherwise, did not address its concerns regarding the “reasonable investigation requirement” and the MSRB should provide its basis for maintaining the requirement. As included in its previous comment letters addressing the “reasonable investigation” requirement, ICI again stated that the MSRB has not provided a sufficient economic analysis of the potential impact of the requirement and should be required to do so with special particularity for “advice rendered in connection with 529 college savings plans.”

In response to these comments, the MSRB stated that the duty of care is a core principle underlying many of the obligations of the proposed rule change, and the proposed requirement to conduct a reasonable investigation is vital because the veracity of the information on which a municipal advisor bases its recommendation can have a significant impact on the ability of a municipal advisor to make informed and suitable

recommendations.<sup>48</sup> The MSRB further stated its belief that the proposed requirement is necessary to promote the integrity of the municipal advisory relationship and protect clients from the potentially costly consequences of transactions undertaken based on unsuitable recommendations. The MSRB reiterated that a municipal advisor would not be required to go to impractical lengths to determine the accuracy and completeness of the information on which it would be basing its advice and/or recommendation.<sup>49</sup> Instead, the MSRB stated that a municipal advisor would be required to investigate using reasonable diligence. The MSRB further stated that it understands that municipal advisors currently, and regularly, follow an industry practice of conducting due diligence and fact finding inquiries that may, or, with some modest modifications, satisfy the requirement to undertake a “reasonable investigation.” In such cases, the MSRB believes the proposed requirement would add only nominal costs, if any.

#### *C. Duty of Care—Preparing Official Statements*

In response to Amendment No. 1 or the OIP, SIFMA commented that proposed paragraph .01 of the Supplementary Material should more explicitly state that municipal advisors assisting in the preparation of any portion of an official statement in connection with a competitive transaction must exercise “reasonable diligence with respect to the accuracy and completeness of any portion of the official statement as to which the municipal advisor assisted in the preparation.”<sup>50</sup> SIFMA stated that while the proposed rule does include a reference to this requirement, the rule language should more explicitly clarify this obligation. In response, the MSRB stated that the rule language, as proposed, is sufficient to alert municipal advisors of their obligation and that the rule language conveys the importance of exercising due care when providing information or advice in connection with the preparation of an official statement.<sup>51</sup>

#### *D. Disclosure of Conflicts of Interest*

Three commenters expressed concerns regarding the differing timing of documentation required by sections

<sup>48</sup> See December Response Letter.

<sup>49</sup> See *id.*; see also Proposing Release, 80 FR 26752, at 26753, 26761, 26763, 26773–74 and 26784; see also August Response Letter.

<sup>50</sup> See SIFMA letter dated September 11, 2015.

<sup>51</sup> See December Response Letter.

<sup>39</sup> See NAMA letter dated May 29, 2015.

<sup>40</sup> See August Response Letter (citing Proposing Release, 80 FR 26752, at 26763, 26773–74, 26783–84).

<sup>41</sup> See letters from Columbia Capital dated September 10, 2015; ICI dated September 11, 2015; NAMA dated September 11, 2015; SIFMA dated September 11, 2015; and WM Financial dated September 11, 2015.

<sup>42</sup> See Columbia Capital letter dated September 10, 2015.

<sup>43</sup> See ICI letter dated September 11, 2015.

<sup>44</sup> See NAMA letter dated September 11, 2015.

<sup>45</sup> See SIFMA letter dated September 11, 2015.

<sup>46</sup> See WM Financial letter dated September 11, 2015.

<sup>47</sup> See ICI letter dated December 1, 2015.



(b) and (c) of Proposed Rule G–42.<sup>52</sup> Each of the commenters recommended that the timing requirement in section (b), on disclosure of conflicts of interest and other information, be changed to match that in section (c), on documentation of the municipal advisory relationship. BDA and GKB believe that disclosures of conflicts of interest only matter when municipal advisors enter into municipal advisory relationships.<sup>53</sup> NAMA stated that the differing timing requirements would lead to “confusing guidance and duplicative disclosures” to clients.<sup>54</sup>

The MSRB previously considered and addressed the same or similar comments regarding the timing requirements of proposed sections (b) and (c),<sup>55</sup> and determined not to make the recommended changes. The MSRB reasoned that the suggested change would conflict with the intention of having municipal advisors disclose conflicts of interest prior to or at least upon engaging in municipal advisory activities and could cause municipal advisors to delay making the required disclosures until the municipal advisory relationship has been reduced to writing, which could be a significant amount of time after the client has received and considered, and potentially acted on, advice or recommendations from the municipal advisor.<sup>56</sup> However, in Amendment No. 1, the MSRB streamlined the steps needed to comply with proposed sections (b) and (c) in proposed paragraph .06 of the Supplementary Material. Under proposed paragraph .06, a municipal advisor would not be required to provide the disclosure of conflicts of interest and other information required under proposed subsection (c)(ii), if the municipal advisor previously fully complied with the requirements of section (b) to disclose such information and subsection (c)(ii) would not require the disclosure of any materially different information than that previously disclosed.

Columbia Capital commented that it supports the requirement in proposed section (b) that a municipal advisor disclose material conflicts of interest prior to or upon engaging in municipal

advisory activities.<sup>57</sup> However, Columbia Capital suggested modifying the rule language to state that a municipal advisor must provide such disclosures “at any time requested by the municipal entity or obligated person, but not later than engaging in” municipal advisory activities. Columbia Capital believed this would provide more clarity regarding the requirement, without changing the substance, and thereby promote better compliance with the proposed section. In response, the MSRB stated that the suggested language would not necessarily provide more clarity to municipal advisors or better aide in compliance with the proposed requirement than the current rule language. The MSRB believes that it would be desirable to maintain the proposed rule language of section (b) because it more clearly coordinates with the language in proposed section (c)<sup>58</sup> regarding the documentation of the municipal advisory relationship and would, therefore, better assist municipal advisors in complying with the different timing requirements of both sections. The MSRB further responded that section (b) contemplates that disclosures may be made at any time prior to engaging in municipal advisory activities, and therefore nothing in the proposed rule change would prevent a municipal advisor and its client from agreeing that the disclosures would be made when requested by the client, so long as the disclosures are made in compliance with all of the terms of proposed section (b) and other applicable rules.

NAMA suggested merging the two “catch-all provisions” in subsections (b)(i)(A) and (b)(i)(G) of Proposed Rule G–42 because it is not clear what the difference is between the two paragraphs.<sup>59</sup> In response, the MSRB combined the disclosures required under paragraphs (b)(i)(A) and (b)(i)(G) in new paragraph (b)(i)(F) of Proposed Rule G–42.<sup>60</sup>

In response to the Proposing Release, WM Financial stated that contingent fees that are based on the completion of a transaction, but not on the size of a transaction, are not a conflict of interest.<sup>61</sup> It argued that contingent fee arrangements benefit municipal entities

by insuring their government funds will not be drawn upon for payment of fees if the transaction is not completed. Accordingly, WM Financial requested that the proposed rule change not require a “conflict of interest” disclosure for contingent fees that do not inherently create conflicts of interest. In response to Amendment No. 1 or the OIP, WM Financial further commented that contingent fee arrangements do not give rise to material conflicts of interest requiring disclosure in every case, and disclosure should not be required of contingent fee arrangements that do not inherently create conflicts of interest.<sup>62</sup> WM Financial believed that such arrangements also serve a useful and beneficial function for municipal entity clients (e.g., for clients with relatively small budgets) in that “governmental funds will not be drawn upon for payment of fees if the transaction is not completed.”

Columbia Capital commented that every type of fee structure “creates a set of incentives and disincentives that can be detrimental to the municipal entity or obligated person,” and specifying contingent compensation arrangements in the proposed rule implies that contingent compensation arrangements are more problematic or imbued with greater conflicts of interest than other compensation arrangements.<sup>63</sup> Columbia Capital suggested that the proposed rule be modified to require municipal advisors to disclose how they are compensated and to discuss incentives and disincentives that result from such compensation arrangements and structures.

In response to these comments, the MSRB stated that requiring municipal advisors to disclose conflicts of interest that could arise from, or are inherent in, contingent compensation is an appropriate and necessary measure to protect municipal entity and obligated person clients.<sup>64</sup> The MSRB noted that, in connection with underwriters, the MSRB requires analogous disclosures in an analogous context. Pursuant to Rule G–17, the MSRB requires a dealer acting as an underwriter to disclose to an issuer whether its underwriting compensation will be “contingent on the closing of a transaction or the size of a transaction,” because, as the MSRB has stated, such circumstances may present a conflict of interest as a result of the underwriter’s financial incentive

<sup>57</sup> See Columbia Capital letter dated September 10, 2015.

<sup>58</sup> Proposed section (c) would require a municipal advisor to “evidence each of its municipal advisory relationships by a writing or writings created and delivered to the municipal entity or obligated person client *prior to, upon or promptly after* the establishment of the municipal advisory relationship.” (emphasis added).

<sup>59</sup> See NAMA letter dated May 29, 2015.

<sup>60</sup> See Amendment No. 1.

<sup>61</sup> See WM Financial letter dated May 29, 2015.

<sup>62</sup> See WM Financial letter dated September 11, 2015.

<sup>63</sup> See Columbia Capital letter dated September 10, 2015.

<sup>64</sup> See December Response Letter.

<sup>52</sup> See letters from BDA dated May 29, 2015; GKB dated May 29, 2015; and NAMA dated May 29, 2015.

<sup>53</sup> See letters from BDA dated May 29, 2015 and GKB dated May 29, 2015.

<sup>54</sup> See NAMA letter dated May 29, 2015.

<sup>55</sup> See Proposing Release, 80 FR 26752, at 26769–70.

<sup>56</sup> See August Response Letter.

to recommend a transaction that is “unnecessary or to recommend that the size of the transaction be larger than is necessary.”<sup>65</sup> The MSRB believes that the scenarios in which proposed paragraph (b)(i)(E) would apply are substantially similar, are subject to the same concerns, and warrant the application of similar disclosure requirements to help make transparent potential conflicts of interest. The MSRB stated that the purpose of the disclosure requirement, is, of course, to allow a municipal advisor’s client to make an informed decision based on relevant facts and circumstances, and, as the MSRB previously explained, municipal advisors would have the opportunity to provide a client with additional context about the benefits and drawbacks of other fee arrangements in relation to a contingent fee arrangement so that the client could choose a fee arrangement that it understands, with which it is comfortable, and that serves its needs.<sup>66</sup> The MSRB further stated that it does not disagree that other fee arrangements also may give rise to conflicts, and noted that other terms of proposed section (b) require broad disclosure of all actual and potential material conflicts of interest. In addition, as the MSRB has emphasized, it does not endorse, nor discourage, the use of any particular lawful compensation arrangement.

#### *E. Documentation of Municipal Advisory Relationship*

GFOA and NAMA expressed concerns with disclosing information regarding legal or disciplinary events through reference to the municipal advisor’s most recent Form MA and Form MA–I.<sup>67</sup> Both commenters stated it was difficult or burdensome for clients to find the relevant Form MA and Form MA–I documents in the SEC’s EDGAR system. GFOA requested the proposed rule be amended to require municipal advisors to provide copies of Form MA–Is directly to their clients as part of the documentation of the relationship, rather than providing the location of the forms.<sup>68</sup> GFOA also suggested that municipal advisors be required to notify clients of changes to Form MA that are material and to provide clients with the updated Form MA with an explanation of how any changes made to the form

materially pertain to the nature of the relationship between the municipal advisor and the client.

In response to the comments, the MSRB noted that the provision in proposed section (b) allowing the municipal advisor to provide legal or disciplinary event disclosures by identifying the specific type of event and referencing the relevant portions of the municipal advisor’s most recent Forms MA or MA–I is permissive, not mandatory.<sup>69</sup> Also in response to GFOA’s comment, the MSRB revised Proposed Rule G–42(c)(iv) to require municipal advisors to provide the client not only the date of the last material change or addition to the legal or disciplinary event disclosures on any Form MA or Form MA–I, but also to provide a brief explanation of the basis for the materiality of each change or addition.<sup>70</sup> The MSRB stated that this explanation would allow a client to assess the effect that such changes may have on the municipal advisory relationship and evaluate whether it should seek or review additional information.<sup>71</sup>

In response to Amendment No. 1 or the OIP, SIFMA objected to the revisions to subsection (c)(iv), requiring municipal advisors to provide a brief explanation of the basis for the materiality of each change or addition, on the grounds that it would be “unnecessary and overly burdensome, outweighing any potential benefit.”<sup>72</sup> SIFMA agreed that municipal advisory clients should have access to information regarding a municipal entity’s legal and disciplinary events, and that clients should receive notifications of material new disclosures. However, in SIFMA’s view, the additional requirement would not create any benefit for a municipal advisor’s client and would result in “additional paperwork burdens” for the municipal advisor. SIFMA added that Form MA and MA–I disclosures, in a manner similar to SEC Forms BD and ADV and the Financial Industry Regulatory Authority (“FINRA”) Form U4, already require an explanation of the events that would also be required to be disclosed and explained under proposed subsection (c)(iv). In response to SIFMA’s comments, the MSRB stated that requiring a municipal advisor to provide a brief explanation of the basis for the materiality of each change or addition would allow a municipal entity client to assess the effect that such

changes may have on the municipal advisory relationship and evaluate whether it should seek or review additional information.<sup>73</sup> When developing this amendment, the MSRB stated that it gave due consideration to comments submitted by GFOA suggesting changes to the information disclosures that GFOA believed would allow issuers to focus more efficiently on disclosures that would be material to them and affect them directly.

NAMA requested the MSRB provide more clarity about the term “detailed information” in the requirement in subsection (c)(iii) that the municipal advisor provide “detailed information specifying where the client may electronically access the municipal advisor’s most recent Form MA and each most recent Form MA–I filed with the Commission.”<sup>74</sup> NAMA suggested the MSRB provide non-exclusive examples; for example, allowing municipal advisors to provide clients with a link to the municipal advisor’s EDGAR page. In response to the comment, the MSRB stated that a municipal advisor would be able to satisfy this aspect of its disclosure obligation by, for example, providing its client with a functioning Uniform Resource Locator (“URL”) to the municipal advisor’s most recent Form MA or MA–I filed with the SEC through the EDGAR system.<sup>75</sup> The MSRB noted that this was only an example and does not preclude other methods of compliance.

#### *F. Documentation Related to Recommendations*

BDA and First Southwest expressed concern that documentation requirements for recommendations are too burdensome.<sup>76</sup> First Southwest estimated that municipal advisors may spend between 20% and 30% of their time writing letters to document compliance, providing a laundry list of consequences that would dilute the advice given, “similar to the way G–17 letters from underwriters have become boiler plate disclosures and have lost significance.”<sup>77</sup> BDA suggested that the proposed rule should specifically state that such communication to clients under section (d) may be oral and is not required to be in writing.<sup>78</sup> BDA was concerned that informing a client of risks, benefits or other aspects of a transaction in writing may not be in the

<sup>65</sup> See *id.* (citing MSRB Interpretive Notice Concerning the Application of MSRB Rule G–17 to Underwriters of Municipal Securities, dated August 2, 2012).

<sup>66</sup> See Proposing Release, 80 FR 26752, at 26764–65; see also August Response Letter.

<sup>67</sup> See letters from GFOA dated June 15, 2015 and NAMA dated May 29, 2015.

<sup>68</sup> See GFOA letter dated June 15, 2015.

<sup>69</sup> See August Response Letter.

<sup>70</sup> See Amendment No. 1.

<sup>71</sup> See August Response Letter.

<sup>72</sup> See SIFMA letter dated September 11, 2015.

<sup>73</sup> See December Response Letter.

<sup>74</sup> See NAMA letter dated May 29, 2015.

<sup>75</sup> See August Response Letter.

<sup>76</sup> See letters from BDA dated May 29, 2015 and First Southwest dated May 29, 2015.

<sup>77</sup> See First Southwest letter dated May 29, 2015.

<sup>78</sup> See BDA letter dated May 29, 2015.

client's best interest because that writing could be obtainable through Freedom of Information Act requests and other means.

In response, the MSRB stated that the documentation required by Proposed Rule G-8(h)(iv) is an appropriately tailored recordkeeping requirement that will assist regulatory examiners in assessing the compliance of municipal advisors with Proposed Rule G-42.<sup>79</sup> In addition, the MSRB stated its belief that the recordkeeping requirements will not be overly burdensome because municipal advisors would be required to maintain only the documents created by the municipal advisor that were material to its review of a recommendation by another party or that memorialize the basis for any conclusions as to suitability.

In response to Amendment No. 1 or the OIP, BDA, Columbia Capital, NAMA and SIFMA expressed concern over the documentation requirement under Proposed Rule G-8(h)(iv), which would require a municipal advisor to keep a copy of any document created by a municipal advisor "that was material to its review of a recommendation by another party or that memorializes the basis for any determination as to suitability."<sup>80</sup> BDA, Columbia Capital and SIFMA expressed concern about the examination of municipal advisors by financial regulators (such as the SEC and FINRA), including the question of how the regulators would determine whether a municipal advisor had complied with the proposed requirements related to recommendations and documentation retention. The commenters stated that the proposed rule change should provide additional guidance on the documentation to be maintained. BDA stated that a transaction on which a municipal advisor is advising may take place over the course of years, and that it would be difficult for a municipal advisor to have a financial regulatory examiner come in after the completion of a transaction and examine the municipal advisor's documentation process. BDA noted that "it just takes one element of omission to find a firm at fault."<sup>81</sup> Finally, BDA commented that, without additional guidance about how a municipal advisor would comply with the proposed provisions addressing recommendations, a discrepancy may occur between information the examiner desired to

review and that which the municipal advisor could provide.

Columbia Capital commented that it would be very difficult for a municipal advisor to "document the rationale for every point of advice in a municipal advisory relationship, including documenting the rationale for every conceivable path not taken."<sup>82</sup> Columbia Capital stated that, without additional specificity, a municipal advisor's recommendation could be subject to unreasonable scrutiny by examiners that would not adequately take into account the totality of the circumstances that impacted the formation of the recommendation provided by the municipal advisor. SIFMA also commented that it is unclear as to what documentation should be maintained to "demonstrate in a regulatory examination" that which the municipal advisor relied upon in making a suitability determination.<sup>83</sup>

In addition, Columbia Capital stated its belief that the recordkeeping requirements "might actually conflict with [a firm's] fiduciary duty where [the] client desires to maintain such internal dialogue in confidence" but where the client (in particular public clients) is subject to open records laws that may frustrate that desire. NAMA stated that the proposed rule is unclear as to whether the document requirements apply to the financing "as a whole" or whether they apply to "every facet of a transaction" which could span several months.<sup>84</sup> SIFMA stated that the proposed documentation requirement is "vastly more burdensome" than the documentation requirement currently applicable to investment advisers.

In response to comments, the MSRB reiterated its belief that Proposed Rule G-8(h)(iv) is an appropriately tailored recordkeeping requirement that will assist regulatory examiners in assessing the compliance of municipal advisors with Proposed Rule G-42.<sup>85</sup> The MSRB stated that the recordkeeping requirement will not be overly burdensome because municipal advisors would be required to maintain only the documents created by the municipal advisor that: (a) Were material to its review of a recommendation by another party or (b) memorialize the basis for any conclusions as to suitability of a recommendation the municipal advisor provided. By limiting the proposed recordkeeping requirement to

documents that were material to the review of a recommendation or that memorialize the basis for a suitability determination as to a recommendation, the MSRB stated it does not believe that the proposed rule would require, as suggested by Columbia Capital, a municipal advisor "to document the rationale for every point of advice" and "the rationale for every conceivable path not taken." In the Proposing Release, the MSRB discussed communications between municipal advisors and their clients, noting that certain communications would constitute recommendations of a municipal securities transaction or municipal financial product and others, advice.<sup>86</sup> The MSRB clarified that only the former triggers a suitability determination under the proposed rule. Therefore, if a municipal advisor's communication with its municipal entity or obligated person client is advice but not a recommendation, the proposed documentation requirement would not apply.

With regard to Columbia Capital's concerns about a municipal advisor maintaining a level of confidentiality as may be requested by a client, the MSRB stated that the proposed rule would not create the conflict discussed because Proposed Rule G-8(h)(iv) would not require a municipal advisor to deliver documents that must be maintained by the municipal advisor to the client or into the possession of a party not privy to, or contemplated under, the municipal advisory relationship.<sup>87</sup> Under Proposed Rule G-42(d), a municipal advisor would be required to "inform" its client, in a manner that comports with its duty of care and the expressed terms of its agreement with its client, of certain aspects of its recommendations, and, the municipal advisor and its client would have some discretion as to the manner in which that information is provided. The MSRB stated its belief that the discretion provided for in the proposed rule will allow a municipal advisor to reasonably accommodate a request by a municipal advisory client such as that described by Columbia Capital and also comply with its fiduciary obligations.

#### G. Suitability Analysis

NAMA supported section (d)'s requirements to inform clients about reasons for a recommendation, however, it stated that greater clarity through a non-exclusive list of examples of how regulated entities could comply with the

<sup>79</sup> See August Response Letter.

<sup>80</sup> See letters from BDA dated September 11, 2015; Columbia Capital dated September 10, 2015; NAMA dated September 11, 2015; and SIFMA dated September 11, 2015.

<sup>81</sup> See BDA letter dated September 11, 2015.

<sup>82</sup> See Columbia Capital letter dated September 11, 2015.

<sup>83</sup> See SIFMA letter dated September 11, 2015.

<sup>84</sup> See NAMA letter dated September 11, 2015.

<sup>85</sup> See December Response Letter.

<sup>86</sup> See *id.* (citing Proposing Release, 80 FR 26752, at 26756).

<sup>87</sup> See December Response Letter.

regulation was needed.<sup>88</sup> Specifically, NAMA suggested the MSRB provide examples of how a municipal advisor should perform its reasonable diligence to satisfy the criteria listed in section (d). NAMA also requested guidance on section (d)(iii), regarding informing a client whether the municipal advisor investigated or considered reasonably feasible alternatives because NAMA was concerned that a municipal advisor would be required to provide a list that was exhaustive and non-germane to the client.

PFM requested the MSRB provide a more concise definition of the term “suitable” to enable municipal advisors to comply with the requirements and stated that the “perfunctory list of generic factors” for consideration in paragraph .08 of the Supplementary Material failed to provide municipal advisors with a clear definition of such an important term.<sup>89</sup>

The MSRB responded to the comments by stating that it chose not to take a more prescriptive or descriptive approach to determining suitability in the proposed rule change because it would risk creating inflexible requirements that would fail to adequately account for the diversity of municipal advisors, the activities in which they engage and the varying needs of clients.<sup>90</sup> In response to NAMA’s request for additional guidance on proposed subsection (d)(iii), the MSRB stated that the language in that subsection would not require a municipal advisor to provide its client with an exhaustive list of “alternative financings” particularly if such alternative financings are not germane to the client. The MSRB stated that the provision also would not require the municipal advisor to conduct a suitability analysis on any “reasonably feasible alternative” considered or investigated by the municipal advisor. Instead, the MSRB noted that the municipal advisor would be obligated only to inform clients whether or not it considered or investigated reasonably feasible alternatives, and the decision whether to have the municipal advisor discuss the alternatives it considered or investigated would be left to the discretion of the municipal advisor and its client.

In response to Amendment No. 1 or the OIP, SIFMA commented that it is unclear when a communication constitutes a “recommendation” (thus triggering a suitability analysis under the proposed rule change), as opposed

to “advice” or, as SIFMA referenced, “ancillary advice.”<sup>91</sup> According to SIFMA’s comment, in order to “design effective policies and procedures, and to evidence compliance with this obligation” municipal advisors need to be certain of when their suitability obligation applies. In SIFMA’s view, because of the uncertainty created by the proposed rule regarding “what is a recommendation versus what is ancillary advice,” FINRA and SEC examiners also would need additional guidance to properly examine for compliance with the rule.

In response to SIFMA’s comments, the MSRB stated that the proposed rule would adopt, and apply to municipal advisors, the existing MSRB interpretive guidance regarding the general principles currently applicable to dealers for determining whether a particular communication constitutes a recommendation of a securities transaction.<sup>92</sup> In conformance with that interpretive guidance, the MSRB noted that it has stated that a municipal advisor’s communication to its client that could reasonably be viewed as a “call to action” to engage in a municipal securities transaction or enter into a municipal financial product would be considered a recommendation and would obligate the municipal advisor to conduct a suitability analysis of its recommendation that adheres to the requirement established by the proposed rule. The MSRB also noted that it previously has stated that, depending on all of the facts and circumstances, communications by a municipal advisor to a client that relate to, but are not recommendations of, a municipal securities transaction or municipal financial product might constitute advice (and therefore trigger many other provisions of the proposed rule change) but would not trigger the suitability obligation set forth in proposed section (d). The MSRB stated that providing a more prescriptive definition of the term “recommendation” is unnecessary and that the proposed rule, along with the related and referenced interpretive guidance that has been in place for dealers for over a decade, will provide municipal advisors, and SEC and FINRA examiners with sufficient guidance on this subject.

In response to the Proposing Release, GFOA expressed concern that the language in subsection (d)(ii) implies that municipal advisors would be permitted to make a recommendation to a client that is unsuitable, which seemed contrary to the proposed rule’s duty of care and loyalty requirements.<sup>93</sup> In Amendment No. 1, the MSRB revised the language in subsection (d)(ii) in response to GFOA’s comment.<sup>94</sup>

#### H. Sophisticated Municipal Issuers

First Southwest requested an exemption to the suitability standard in proposed section (d) and paragraph .08 of the Supplementary Material for “sophisticated municipal issuers.”<sup>95</sup> First Southwest stated that certain issuers are capable of independently evaluating risks in issuing municipal securities, and exercising independent judgment in evaluating recommendations of a municipal advisor. In response to the comment, the MSRB noted that when the SEC adopted the final municipal advisor registration rule<sup>96</sup> it did not include an exemption from registration as a municipal advisor for persons providing advice to clients of a certain sophistication.<sup>97</sup> The MSRB stated its belief that it would be premature to categorically exclude certain clients from the protections of the proposed rule given that municipal advisors have become subject only recently to the SEC’s regulatory framework governing their registration and the MSRB’s developing regulatory framework for municipal advisors.

#### I. Inadvertent Advice

SIFMA suggested that the safe harbor in paragraph .06<sup>98</sup> of the Supplementary Material for inadvertent advice be expanded to include the prohibition on principal transactions.<sup>99</sup> SIFMA argued that firms would be unlikely to rely on the safe harbor unless it also provided an exemption for inadvertent advice triggering the prohibition on principal transactions.

In response to these comments, the MSRB stated that section (d) of Proposed Rule G–42 applies only in the case where a municipal advisor makes a recommendation of a municipal securities transaction or municipal

<sup>88</sup> See NAMA letter dated May 29, 2015.

<sup>89</sup> See PFM letter dated May 29, 2015.

<sup>90</sup> See August Response Letter.

<sup>91</sup> See First Southwest letter dated May 29, 2015.

<sup>92</sup> See Registration of Municipal Advisors, Exchange Act Release No. 70462 (September 20, 2013), 78 FR 67467 (November 12, 2013) (“SEC Final Rule”).

<sup>93</sup> See August Response Letter.

<sup>94</sup> Proposed paragraph .06 was renumbered in Amendment No. 1 as proposed paragraph .07.

<sup>95</sup> See SIFMA letter dated May 28, 2015.

<sup>91</sup> See SIFMA letter dated September 11, 2015.

<sup>92</sup> See December Response Letter (citing Proposing Release, 80 FR 26752, at 26756 n. 18 (citing MSRB Rule G–19 and MSRB Notice 2002–30 (September 25, 2002), Notice Regarding Application of Rule G–19, on Suitability of Recommendations and Transactions, to Online Communications)).

<sup>88</sup> See NAMA letter dated May 29, 2015.

<sup>89</sup> See PFM letter dated May 29, 2015.

<sup>90</sup> See August Response Letter.

financial product, or where within the scope of the engagement and at the client's request, the municipal advisor reviews a recommendation of a third party.<sup>100</sup> The MSRB believes these limitations will address SIFMA's concerns to some degree. In addition, the MSRB stated that other commenters expressed concern that if the safe harbor were to relieve municipal advisors from compliance with proposed subsection (e)(ii), on principal transactions, the provision might be misinterpreted or misused in a manner contrary to the purposes of the SEC's registration regime and the fiduciary duty owed to municipal entity clients.

In response to Amendment No. 1 or the OIP, Columbia Capital expressed concern regarding the inadvertent advice exemption, stating it is "rife for abuse" and that the MSRB should define "inadvertent" very narrowly.<sup>101</sup> WM Financial argued that the inadvertent advice provision creates a loophole that would allow broker dealers to serve as financial advisors (without a fiduciary duty) and then switch to serving as an underwriter by claiming that such advice was inadvertent.<sup>102</sup> WM Financial suggested that any entity relying on the inadvertent advice provision should be required to file the required documentation not only with the issuer, but also with the MSRB, and that the filing should be made public. In addition, WM Financial suggested that any entity relying on the inadvertent advice provision be allowed to rely on the exception only one time in any calendar year.

In response to the comments, the MSRB noted that the inadvertent advice exemption would only apply when a municipal advisor inadvertently engages in municipal advisory activities but does not intend to continue the municipal advisory activities or enter into a municipal advisory relationship.<sup>103</sup> The MSRB further explained that the proposed paragraph would only relieve the municipal advisor from complying with proposed sections (b) and (c) (relating to disclosure of conflicts of interest and documentation of the relationship) of Proposed Rule G-42, and not any other requirements. The MSRB believes that proposed paragraph .07 is sufficiently clear with regard to the narrow relief it allows and that the obligations that

municipal advisors would be required to undertake to obtain that relief are adequate to curb the types of abuse about which commenters have expressed concern.

#### J. Prohibition on Delivering Inaccurate Invoices

SIFMA expressed support for the prohibition on delivering inaccurate invoices, but requested the addition of materiality and knowledge qualifiers (*i.e.*, a municipal advisor may not *intentionally* deliver a *materially* inaccurate invoice), so that immaterial or unintentional errors would not be prohibited.<sup>104</sup> In response to the comment, the MSRB modified Proposed Rule G-42(e)(i)(B) to prohibit "delivering an invoice . . . for municipal advisory activities that is materially inaccurate in its reflection of the activities actually performed or the personnel that actually performed those activities" and to delete the words "do not accurately reflect" within the same provision.<sup>105</sup> The MSRB declined to add a state-of-mind requirement as SIFMA requested because it would not sufficiently protect municipal entity and obligated person clients.

#### K. Prohibited Principal Transactions

In response to the Proposing Release, ten commenters expressed a variety of concerns with the prohibition on certain principal transactions in Proposed Rule G-42(e)(ii).<sup>106</sup> In response to Amendment No. 1 or the OIP, seven commenters addressed the proposed prohibition on certain principal transactions.<sup>107</sup> In Amendment No. 2, the MSRB incorporated the Exception to the principal transaction ban in response to the comments received. In response to Amendment No. 2, six commenters addressed the Exception.<sup>108</sup>

##### 1. Consistency With Exchange Act

BDA, FSI, Millar Jiles, SIFMA and Zions commented that, if no exception

<sup>104</sup> See SIFMA letter dated May 28, 2015.

<sup>105</sup> See Amendment No. 1; *see also* August Response Letter.

<sup>106</sup> See letters from SIFMA dated May 28, 2015; Zions dated May 29, 2015; ABA dated May 29, 2015; BDA dated May 29, 2015; GKB dated May 29, 2015; Millar Jiles dated May 29, 2015; FSI dated May 29, 2015; GFOA dated June 15, 2015; Wells Fargo dated May 29, 2015; and NAMA dated May 29, 2015.

<sup>107</sup> See letters from BDA dated September 11, 2015 and December 1, 2015; Coastal Securities dated September 11, 2015; FSI dated September 11, 2015; GFOA dated September 14, 2015; Millar Jiles dated September 11, 2015; SIFMA dated September 11, 2015; and Zions dated September 10, 2015.

<sup>108</sup> See letters from BDA dated December 1, 2015; FSI dated December 1, 2015; GFOA dated December 1, 2015; NAMA dated December 1, 2015; SIFMA dated December 1, 2015; and Spencer Wright dated December 16, 2015.

to the proposed principal transaction ban were added, the Proposed Rule would be inconsistent with one or more of the following provisions of the Exchange Act:<sup>109</sup> Section 15B(b)(2)(L),<sup>110</sup> Section 15B(b)(2)(L)(i),<sup>111</sup> Section 15B(b)(2)(C),<sup>112</sup> and Section 3(f).<sup>113</sup> The commenters suggested exceptions to the proposed ban or other changes, including an exception modeled on those found in other regulatory regimes, an exception when advice is provided to a municipal entity client that is incidental to securities execution services, an exception limited to riskless principal transactions in certain fixed income securities, an exception when the municipal entity is otherwise represented with respect to the principal transaction by another registered municipal advisor, an exception for affiliates or remote businesses, and modifications to narrow the scope of the prohibition.

The MSRB responded to the foregoing comments by incorporating the Exception to the principal transaction ban, as discussed below under "Exception to Principal Transaction Ban."

##### 2. Comparison With Similar Regulatory Regimes

In response to the Proposing Release, SIFMA and Zions expressed concerns that the prohibition on principal transactions is overbroad and inconsistent with existing regulatory regimes regarding financial professionals.<sup>114</sup> Both commenters argued that restrictions on principal transactions for municipal advisors and their affiliates should be consistent with those on investment advisers, who are permitted to engage in principal transactions provided they make relevant disclosures and obtain client consent.

In response to Amendment No. 1 or the OIP, BDA, Coastal Securities, FSI, Millar Jiles, SIFMA and Zions commented that the principal transaction ban should be revised to

<sup>109</sup> See letters from BDA dated September 11, 2015; FSI dated September 11, 2015; Millar Jiles dated September 11, 2015; SIFMA dated September 11, 2015; and Zions dated September 10, 2015 (raising concerns regarding the following provisions of the Exchange Act, in connection with the principal transaction ban: Section 15B(b)(2)(L) (SIFMA and Zions); Section 15B(b)(2)(L)(i) (BDA, FSI, SIFMA and Zions); Section 15B(b)(2)(C) (FSI, SIFMA and Zions); and Section 3(f) (Millar Jiles and SIFMA)).

<sup>110</sup> 15 U.S.C. 78o-4(b)(2)(L).

<sup>111</sup> 15 U.S.C. 78o-4(b)(2)(L)(i).

<sup>112</sup> 15 U.S.C. 78o-4(b)(2)(C).

<sup>113</sup> 15 U.S.C. 78c(f).

<sup>114</sup> See letters from SIFMA dated May 28, 2015 and Zions dated May 29, 2015.

<sup>100</sup> See August Response Letter.

<sup>101</sup> See Columbia Capital letter dated September 10, 2015.

<sup>102</sup> See WM Financial letters dated May 29, 2015 and September 11, 2015.

<sup>103</sup> See December Response Letter.

permit municipal advisors to engage in principal transactions with their municipal entity clients, provided that disclosure of conflicts is made to the client and the client consents.<sup>115</sup> Commenters suggested that the MSRB consider incorporating an exception to the proposed ban modeled on, or similar to, Section 206(3) of the Investment Advisers Act of 1940 (“Advisers Act”)<sup>116</sup> or Advisers Act Rule 206(3)–3(T),<sup>117</sup> available to firms dually registered as a broker-dealer and investment adviser.<sup>118</sup> FSI and Millar Jiles stated that a ban on principal transactions was unnecessary in view of the fiduciary relationship between a municipal advisor and its municipal entity client. Zions commented that the proposed ban is inconsistent with the federal regulation of investment advisers, and stated that the MSRB has no basis for treating municipal advisors differently than investment advisers when setting fiduciary duty standards, and municipal advisors should be permitted to engage in principal transactions with their municipal entity clients, provided that advice and consent requirements are met. FSI suggested an exception to the ban could include certain disclosure and client consent provisions similar to Advisers Act Temporary Rule 206(3)–3T that permits investment advisers that are also broker-dealers to act in a principal capacity in transactions with certain advisory clients.<sup>119</sup> FSI also suggested the proposed exception be limited to certain fixed-income securities as defined by Rule 10b–10(d)(4).

The MSRB responded to the foregoing comments by incorporating the Exception to the principal transaction ban, as discussed below under “Exception to Principal Transaction Ban.”

### 3. Advice Incidental to Securities Execution Services

FSI, GFOA and SIFMA requested an exemption to the principal transaction prohibition when advice is provided to a municipal entity client that is incidental to or ancillary to a broker-dealer’s execution of securities transactions, including transactions involving municipal bond proceeds or

municipal escrow funds.<sup>120</sup> GFOA expressed concern that the proposed prohibition could force small governments to establish “a more expensive fee-based arrangement with an investment adviser in order to receive this very limited type of advice on investments that are not risky.”<sup>121</sup>

In response to Amendment No. 1 or the OIP, BDA, FSI, GFOA, and SIFMA also suggested that the MSRB consider an exception to the ban for limited advice that is incidental to securities execution services.<sup>122</sup> GFOA acknowledged that the ban makes sense in the context of a traditional financial advisor, however, GFOA was concerned about what it viewed to be a removal of the issuer from the conflicts of interest process and the lack of an exception to the proposed ban regarding the investment of proceeds of municipal securities and municipal escrow investments.<sup>123</sup> FSI stated that a ban on transactions, where the advice is incidental to the securities execution services, would impose an unnecessary burden on competition, and suggested an exception be incorporated for transactions executed in such circumstances.<sup>124</sup> FSI also suggested that the exception could be limited to transactions in certain fixed income securities or, alternatively, limited to riskless principal transactions in certain fixed income securities. Commenters, including BDA, FSI, GFOA, Millar Jiles, SIFMA and Zions, noted the importance, in their view, of: (i) Preserving municipal entities’ choice and access to services and products at favorable prices; (ii) preserving municipal entities’ access to financial advisors with whom such municipal entities have relationships; and (iii) avoiding increased costs to municipal entities.<sup>125</sup>

The MSRB responded to the foregoing comments by incorporating the Exception to the principal transaction ban, as discussed below under “Exception to Principal Transaction Ban.”

### 4. Scope of Principal Transaction Ban: “Directly Related To”

BDA, GKB and SIFMA expressed concern that the language in subsection (e)(ii) limiting the principal transaction prohibition to transactions “directly related to the same municipal securities transaction or municipal financial product” is vague or overly broad.<sup>126</sup> One of the commenters proposed alternative language prohibiting a principal transaction “if the structure, timing or terms of such principal transaction was established on the advice of the municipal advisor. . . .”<sup>127</sup> The commenter also requested clarification regarding the application of the principal transaction ban to several specific scenarios.<sup>128</sup>

SIFMA argued that any prohibition should be more narrowly tailored to prevent principal transactions directly related to the advice provided by the municipal advisor.<sup>129</sup> SIFMA believed that, as written, the prohibition would prevent a firm from acting as counterparty on a swap after having advised a municipal entity client on investing proceeds from a connected issuance of municipal securities. SIFMA proposed alternative language prohibiting principal transactions “directly related to the *advice rendered by such municipal advisor.*” SIFMA also requested clarification regarding when a ban would end because as written, the prohibition would require firms to check for advisory relationships that may have ended long before the proposed principal transaction takes place.

In response to Amendment No. 1 or the OIP, SIFMA commented that the MSRB failed to consider a suggestion to amend the ban to limit its scope to principal transactions that are directly related to the advice provided by the municipal advisor.<sup>130</sup>

In response to the comments, the MSRB determined not to narrow, broaden or otherwise modify the standard in this regard.<sup>131</sup> The MSRB stated its belief that the alternative rule text suggested by SIFMA would not be a more effective or efficient means for achieving the stated objective of the proposed ban, which is to eliminate a category of particularly acute conflicts of interest that would arise in a

<sup>120</sup> See letters from FSI dated September 11, 2015; GFOA dated June 15, 2015; and SIFMA dated May 28, 2015.

<sup>121</sup> See GFOA letter dated June 15, 2015.

<sup>122</sup> See letters from BDA dated November 4, 2015; FSI dated September 11, 2015; GFOA dated September 14, 2015; and SIFMA dated September 11, 2015.

<sup>123</sup> See GFOA letter dated June 15, 2015.

<sup>124</sup> See FSI letters dated May 29, 2015 and September 11, 2015.

<sup>125</sup> See letters from BDA dated September 11, 2015 and November 4, 2015; FSI dated September 11, 2015; GFOA dated September 14, 2015; Millar Jiles dated September 11, 2015; SIFMA dated September 11, 2015; and Zions dated September 10, 2015.

<sup>126</sup> See letters from BDA dated May 29, 2015; GKB dated May 29, 2015; and SIFMA dated May 28, 2015.

<sup>127</sup> See letters from BDA dated May 29, 2015 and GKB dated May 29, 2015.

<sup>128</sup> See BDA letter dated May 29, 2015.

<sup>129</sup> See SIFMA letter dated May 28, 2015.

<sup>130</sup> See SIFMA letter dated September 11, 2015.

<sup>131</sup> See MSRB Response Letters.

<sup>115</sup> See letters from BDA dated September 11, 2015; Coastal Securities dated September 11, 2015; FSI dated September 11, 2015; Millar Jiles dated September 11, 2015; SIFMA dated September 11, 2015; and Zions dated September 10, 2015.

<sup>116</sup> 15 U.S.C. 80b–6(3) (“Section 206(3)”).

<sup>117</sup> 17 CFR 275.206(3)–3T (“IA Rule”).

<sup>118</sup> See, e.g., letters from BDA dated September 11, 2015; FSI dated September 11, 2015; Millar Jiles dated September 11, 2015; SIFMA dated September 11, 2015; and Zions dated September 10, 2015.

<sup>119</sup> See FSI letter dated May 29, 2015.

fiduciary relationship between a municipal advisor and its municipal entity client. In this context, the MSRB noted that the suggested change could leave transactions that have a high risk of self-dealing insufficiently addressed.

The MSRB modified the proposed ban to incorporate the Exception, discussed below under “Exception to Prohibited Principal Transactions.” In light of the MSRB’s incorporation of the Exception, the MSRB stated its belief that it is not appropriate to further modify the ban at this time.<sup>132</sup>

#### 5. Affiliates or “Remote Businesses”

In response to the Proposing Release, SIFMA and Wells Fargo addressed concerns regarding the impact of the principal transaction prohibition on affiliates of municipal advisors.<sup>133</sup> Wells Fargo stated that the MSRB should exempt municipal advisor affiliates operating with information barriers, and stated that if an affiliate has no actual knowledge of the municipal advisory relationship between the municipal entity client and the municipal advisor due to information barriers and governance structures, the risk of a conflict of interest is significantly diminished.<sup>134</sup> SIFMA proposed the addition of a knowledge standard (*i.e.*, to prohibit a municipal advisor and any affiliate from *knowingly* engaging in a prohibited principal transaction), arguing that such a knowledge standard is consistent with Section 206(3) of the Advisers Act.<sup>135</sup> SIFMA suggested that an investment vehicle such as a mutual fund that is advised by a municipal advisor or its affiliate should not itself be an “affiliate” of the municipal advisor solely on the basis of the advisory relationship. Otherwise, SIFMA argued the investment fund may be unable to invest in a municipal security if an affiliate of the fund’s advisor acted as a municipal advisor on the transaction. SIFMA stated that the ban in this type of situation is unnecessary because mutual funds and similar vehicles have independent boards and their affiliates do not have significant equity stakes in the funds they advise.

In response to Amendment No. 1 or the OIP, SIFMA commented that the MSRB failed to consider limiting the application of the ban to affiliates of a municipal advisor that have no knowledge of the municipal advisory engagement, or more broadly to

affiliates and business units of the municipal advisor that have no such knowledge.<sup>136</sup> SIFMA commented that the proposed rule would “significantly harm competition” because it would lead to municipal advisor firms exiting the municipal advisory marketplace. SIFMA commented that a decrease in municipal advisors may result in the remaining firms increasing their fees and a deterioration in the quality of the services provided by municipal advisory firms.

In response to the comments, the MSRB stated its belief that the proposed ban, as to affiliates, is appropriately targeted given the acute nature of the conflicts of interest presented and the risk of self-dealing by affiliates in transactions that are “directly related” to the municipal securities transaction or municipal financial product as to which the affiliated municipal advisor has provided advice.<sup>137</sup> The MSRB believes that the concerns expressed by various commenters, including the concerns regarding the potential impact on competition in the municipal advisory marketplace, will be substantially mitigated, if they at all manifest, by the MSRB’s inclusion of the Exception to the principal transaction ban.

#### 6. Bank Loans

Several commenters expressed concerns with proposed paragraph .11 of the Supplementary Material under which a bank loan would be subject to the prohibition on principal transactions if the loan was “in an aggregate principal amount of \$1,000,000 or more and economically equivalent to the purchase of one or more municipal securities.”<sup>138</sup>

ABA expressed a general concern that banking organizations that are required to operate through a variety of affiliates and subsidiaries would fall within the scope of the “common control” definition in the statute and the prohibition would prevent a banking organization from providing ordinary bank services to a municipal entity.<sup>139</sup> ABA also requested the prohibition be amended to exclude bank loans made by an affiliate from the definition of “other similar financial products” if the bank enters into the loan after the municipal

entity solicits bidders for such loan using a request for proposal and the bank intends to hold the loan on its books until maturity. ABA believed that there should be few concerns regarding conflicts if a loan is entered into by an affiliate of a municipal advisor and a municipal entity would be free to choose its lender based on factors most appropriate for the municipality and its taxpayers. In addition, ABA stated that the potential conflicts of interest should be substantially mitigated if a bank holds a loan on its books to maturity because in such cases, the commenter believes the interest of the municipal entity and the bank are aligned in that each party wants funding that serves the particular needs of the municipal entity and both parties must be satisfied that the loan can be repaid and desire that it be repaid.<sup>140</sup>

Similarly, Millar Jiles suggested that a municipal advisor should be able to satisfy its fiduciary obligation to a municipal entity by procuring bids for the proposed financing (and thus make a principal bank loan through an affiliated entity permissible), stating that if the affiliate of the municipal advisor were the lowest bidder, the municipality would be penalized by being forced to borrow at a higher rate under the proposed rule change.<sup>141</sup>

The MSRB responded that even if both elements (*i.e.*, the use of an RFP and intent to hold a loan to maturity) were incorporated as conditions to exclude certain principal transactions from the prohibition in Proposed Rule G-42(e)(ii), the conflicts of interest are not sufficiently mitigated to eliminate the concerns of overreaching and self-dealing and other actions inconsistent with the fiduciary duty between a municipal and its client.<sup>142</sup> The MSRB reasoned that the bank and borrower are counterparties with conflicting interests, and a lender’s intent at one point in time to hold a loan on its books until maturity would provide insufficient controls or checks over conflicts of interest inherent in the transaction. The MSRB explained that at any time after making the loan, a bank would be free to change its intent and sell the loan if doing so was in the bank’s best interest. The MSRB also stated its belief that an RFP process does not protect a municipal entity sufficiently from conflicts of interest because, for example, a municipal advisor may be able to inappropriately influence the municipal entity client to obtain a loan instead of issuing a municipal security,

<sup>132</sup> The MSRB responded to a prior comment by SIFMA regarding this matter, stating that SIFMA’s suggestion to add a knowledge qualifier would be overly stringent, which could hinder regulatory examinations and enforcement. See August Response Letter.

<sup>133</sup> See December Response Letter.

<sup>134</sup> See letters from ABA dated May 29, 2015; Millar Jiles dated May 29, 2015; BDA dated May 29, 2015; and Zions dated May 29, 2015.

<sup>135</sup> See ABA letter dated May 29, 2015.

<sup>132</sup> See December Response Letter.

<sup>133</sup> See letters of SIFMA dated May 28, 2015 and Wells Fargo dated May 29, 2015.

<sup>134</sup> See Wells Fargo letter dated May 29, 2015.

<sup>135</sup> See SIFMA letter dated May 28, 2015.

<sup>140</sup> *Id.*; see also Zions letter dated May 29, 2015.

<sup>141</sup> See Millar Jiles letter dated May 29, 2015.

<sup>142</sup> See August Response Letter.



or to influence the RFP process or requirements to favor the selection of the municipal advisor's bank affiliate as lender.

Zions argued that bank loans "should be excluded in their entirety" from Proposed Rule G-42.<sup>143</sup> Zions believed that it would be paradoxical to allow individuals and private businesses to borrow money from banks that are fiduciaries, but to prevent municipal entities from doing the same. Alternatively, Zions requested that MSRB increase the threshold loan amount in paragraph .11 of the Supplementary Material to align with the bank qualified exemption amount in the Internal Revenue Code, which it states is currently \$10 million.

In response to Zions's comments, the MSRB noted that proposed paragraph .12, on principal transactions—other similar financial products, is limited substantially and would target only those loans that would be the same as, or directly related to, the municipal securities transaction or municipal financial product as to which the municipal advisor is providing or has provided advice and which would be considered "economically equivalent to the purchase of one or more municipal securities."<sup>144</sup> The MSRB also responded to the comments regarding increasing the threshold from \$1 million to \$10 million by stating the same threshold is used in other aspects of the regulation of municipal securities such as SEC Rule 15c2-12,<sup>145</sup> and that after the MSRB has experience with the rule as in effect, the MSRB may solicit information regarding whether the threshold should be modified.

In response to Amendment No. 1 or the OIP, Zions commented that the principal transaction ban is overly broad and inconsistent with federal banking laws, and, as an alternative to generally permitting principal transactions (subject to disclosure and consent requirements), bank loans should be excluded in their entirety from the ban.<sup>146</sup> Zions commented that banks, as highly regulated entities, should be allowed to continue offering traditional banking services to municipal entities, including as principal. Zions further commented that determining on a case-by-case basis whether a particular transaction is economically equivalent to the purchase of one or more municipal securities is unnecessarily complex and costly for products that are already thoroughly regulated. As an

example of the complexity of applying the standard, Zions stated that the written evidence of indebtedness from municipal entities must have virtually the same structure and provisions that would be in place for a municipal security. Zions stated that the only clear way to distinguish between direct bank loans and municipal securities is to look at the intent of the acquirer at the time of acquisition. In Zions's view, if the indebtedness is acquired with an intent to distribute, the instrument should be deemed a security, but if a bank acquires the indebtedness directly for its own portfolio with no intent to distribute, the instrument is, and should be treated as, a bank loan. If bank loans are potentially subject to the ban, Zions suggested, as an alternative, that the threshold bank loan amount be higher than \$1 million. Zions believed that the threshold amount should be consistent with, and pegged to, the \$10 million threshold for bank-qualified obligations under Section 265 of the Internal Revenue Code.<sup>147</sup> In addition, Zions commented that, for the Proposed Rule to be consistent with the Exchange Act, the proposed threshold should be raised to \$10 million. Zions also commented that unless the threshold amount was increased, the proposed ban would be inconsistent with the goals of the Community Reinvestment Act ("CRA").<sup>148</sup> Zions believed that the ban may prevent municipal advisors, such as Zions, from issuing direct loans to smaller and more remote municipal entities and/or cause banks to provide services to underserved municipalities in less than all three of the required categories of the CRA (*i.e.*, lending, investments and financial services).

In response to Zions's comments, the MSRB stated that the concerns are addressed to some extent by the bank exemption from the definition of "municipal advisor."<sup>149</sup> In addition, the MSRB stated that even in situations where a bank's provision of advice were not exempt and Proposed Rule G-42 and the ban applied, Zions's concerns referenced above and its concern regarding the impact to smaller communities or projects in such communities as a result of the proposed ban, should be substantially ameliorated because the MSRB has added the Exception. The MSRB explained that bank loans were included in the ban and should remain as a "similar financial product" because, as a matter of market practice, bank loans serve as

a financing alternative to the issuance of municipal securities and pose a comparable, acute potential for self-dealing and other breaches of the fiduciary duty owed by a municipal advisor to a municipal entity client. The MSRB also stated that it does not find support in the comments for importing into the proposed term "Other Similar Financial Products" an unrelated dollar threshold (*i.e.*, \$10 million) from a statutory provision regarding the bank qualification of municipal securities, in lieu of the proposed \$1 million threshold.

In response to Zions's comments that the principal transaction ban should be eliminated because of its possible impact on the CRA, the MSRB noted that the proposed prohibition on principal transactions is narrowly targeted and would have a limited impact on a municipal advisor or its affiliate providing loans and financial services, generally. The MSRB also stated that Zions's comments do not demonstrate—and the MSRB is not aware of any indication—that Congress intended the requirements of the CRA to take precedence over other statutory and regulatory requirements.

BDA commented on the language of paragraph .11 of the Supplementary Material, arguing that the phrase "economically equivalent" is "too ambiguous and does not provide clarity."<sup>150</sup> BDA acknowledged this phrase appeared intended to develop a standard that does not require the determination of when a bank loan constitutes a security, and acknowledged difficulties applying the *Reves*<sup>151</sup> test to make such a determination. However, BDA argued that this language will "compound the confusion" and requested that the MSRB be clear about which structural components of a direct purchase structure would cause it to fall within the scope of the transaction ban.

The MSRB responded that not all loans of \$1 million or more would be considered an "other similar financial product," and that determination would depend on the facts and circumstances regarding a particular loan, including structure and marketing.<sup>152</sup> In response to BDA's comment about applying the *Reves* test, the MSRB stated that *Reves* would not be the appropriate test to determine whether a bank loan is considered an "other similar financial product," because the defined term is drafted intentionally to include bank

<sup>143</sup> See Zions letter dated May 29, 2015.

<sup>144</sup> See August Response Letter.

<sup>145</sup> 17 CFR 240.15c2-12(a).

<sup>146</sup> See Zions letter dated September 10, 2015.

<sup>147</sup> 26 U.S.C. 265 *et seq.*

<sup>148</sup> 12 U.S.C. 2901 *et seq.*

<sup>149</sup> See December Response Letter (citing 17 CFR 240.15Ba1-1(d)(e)(iii)).

<sup>150</sup> See BDA letter dated May 29, 2015.

<sup>151</sup> *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

<sup>152</sup> See August Response Letter.

loans other than those that are a security.

Millar Jiles also expressed confusion regarding the “economically equivalent” language.<sup>153</sup> Millar Jiles requested clarity regarding the time period over which bank loans should be aggregated in order to determine whether a series of loans meets the “aggregate principal amount” threshold specified in paragraph .11 of the Supplementary Material. Millar Jiles also noted that the typical bank loan to a municipal entity is for the purchase of equipment and is payable over a term of less than five years, while the typical municipal security is secured by a pledge of revenues and is payable over a much longer term. Millar Jiles asked whether a bank loan of \$1,500,000 which is secured by real or personal property and which is payable over a term of five years or less would be “economically equivalent to the purchase of one or more municipal securities.”

In response to Millar Jiles’s comments, the MSRB stated that whether one or more loans would be aggregated to reach the \$1 million threshold would depend on the facts and circumstances surrounding the transactions, including but not limited to factors such as how close in time to the other the loans occurred, the purpose of each loan and the similarity of purpose among the loans, and whether such loans are components of a more comprehensive plan of financing. The MSRB clarified that no single factor would be determinative in such an analysis.

#### 7. Separate Registered Municipal Advisor

SIFMA suggested the proposed subsection (e)(ii) be revised to permit an otherwise prohibited principal transaction where the municipal entity is represented by more than one municipal advisor, including a separate registered municipal advisor with respect to the principal transaction.<sup>154</sup> SIFMA argued this exemption would be comparable to the independent registered municipal advisor exemption, and would permit municipal entities to contract with a counterparty of their choice. SIFMA also noted this would be especially beneficial to municipal entities who may hire several municipal advisors for different elements of the same transaction.

The MSRB concluded that the incorporation at this stage of an

exception to the ban like that suggested by SIFMA would be premature, add additional and unnecessary complexity, and be potentially burdensome to administer.<sup>155</sup> To provide appropriate protection to municipal entities while including an exception such as that suggested by SIFMA, it likely would be necessary to impose a number of conditions, as the MSRB previously noted.<sup>156</sup> The MSRB believes that the Exception to the proposed ban is the more appropriate approach to maintain the necessary protections for municipal entities, investors and the public while helping to ensure that issuers will continue to have access to a competitive market for municipal advisory and other financial services. The MSRB believes the Exception will provide a useful, practical path for a municipal advisor that is otherwise prohibited from engaging in certain principal transactions with its municipal entity client to do so, subject to the stated terms and conditions, and the MSRB has proposed the Exception to be responsive to the comments from a range of commenters, including SIFMA.

#### 8. Governing Body Approval

In response to Amendment No. 1 or the OIP, BDA suggested that the principal transaction ban be amended not only for municipal advisors providing advice in connection with the trading of principal securities, but also to allow most principal transactions if the transaction is approved by the governing body of the municipal entity client after the governing body has been fully informed about any actual or potential conflicts of interest associated with the principal transaction.<sup>157</sup>

In response to BDA’s comment, the MSRB stated that BDA’s proposed exception was quite broadly drawn and may, in many instances, not address the type of self-dealing transactions and the resulting abuses from self-dealing that the statutory requirements and the developing regulatory framework for municipal advisors were intended to address.<sup>158</sup> Even if both conditions (*i.e.*, disclosure of potential and actual conflicts of interest and a vote approving the transaction) were incorporated in an exception of the scope suggested by BDA, the MSRB believes that the conflicts of interest of the municipal entity’s counter-party—its own municipal advisor—would be fully present, and not sufficiently

mitigated to eliminate or substantially reduce the concerns of overreaching and self-dealing and other actions inconsistent with the fiduciary duty of the municipal advisor. The MSRB believes that the Exception to the proposed principal transaction ban is responsive to the concerns raised by the BDA generally.

#### 9. Exception to Principal Transaction Ban

In response to Amendment No. 2, the SEC received six comment letters on the principal transaction ban and the proposed Exception.<sup>159</sup> NAMA supported the proposed rule change, as amended by Amendment No. 1 and Amendment No. 2, and urged the SEC to approve it “without further erosion of the important principal transaction ban that is in place to protect issuers.”<sup>160</sup> NAMA stated its belief that the Exception is sufficient to accomplish the proposed rule’s objective “in light of the difficulties principal transactions raise.”

SIFMA commented that the Exception shows movement toward a more workable construct than the complete principal transaction ban, but that “importing into the Exception all of the procedural accoutrements of Section 206(3) and Rule 206(3)–3T, adopted in another context,” has resulted in the Exception being unreasonably limited and unworkable in practice.<sup>161</sup> SIFMA also commented that the Exception’s requirements for the alternative under proposed paragraph .14(d)(2) of the Supplementary Material to obtain additional transaction-by-transaction consent undermines the utility of obtaining advance written consent, and presents challenging issues of documentation and recordkeeping. SIFMA stated that it would present unworkable challenges to the municipal advisor and municipal entities that may seek to execute ordinary course transactions “several times per day or more.” SIFMA stated that the procedural requirements included in proposed paragraph .14(d)(2), in the context of Advisers Act Rule 206(3)–3T,<sup>162</sup> have discouraged broker-dealers from relying on that rule and have limited its ultimate utility.

BDA acknowledged that the Exception has addressed what it termed “marginal considerations surrounding

<sup>159</sup> See letters from BDA dated December 1, 2015; FSI dated December 1, 2015; GFOA dated December 1, 2015; NAMA dated December 7, 2015; SIFMA dated December 1, 2015; and Spencer Wright dated December 16, 2015.

<sup>160</sup> See NAMA letter dated December 7, 2015.

<sup>161</sup> See SIFMA letter dated December 1, 2015.

<sup>162</sup> 17 CFR 275.206(3)–3T.

<sup>155</sup> See December Response Letter.

<sup>156</sup> See August Response Letter (identifying some of the substantial additional relationship documentation that likely would be required).

<sup>157</sup> See BDA letter dated November 4, 2015.

<sup>158</sup> See December Response Letter.

<sup>153</sup> See Millar Jiles letter dated May 29, 2015.

<sup>154</sup> See SIFMA letters dated May 28, 2015 and September 11, 2015.

the principal transactions ban,” but, in its view, an exception would not be “meaningful and useful” unless the municipal advisor could “provide[] advice to the municipal entity in connection with the issuance of municipal securities the proceeds of which are being invested.”<sup>163</sup> BDA also commented that the consent and disclosure requirements are too burdensome to be useful, and, as a practical matter, the provisions would require transaction-by-transaction written consent since the alternative (to obtaining such consents) is too extensive to make it worth a dealer’s effort. BDA recognized that the MSRB followed the principles in the investment adviser context, but believed that the approach “does not take into consideration the vast differences between brokerage operations and investment advisory operations.”

In response to these comments, the MSRB first explained that the issues raised by the Exception arise with respect to a limited universe of municipal advisory activities—namely, advising with respect to the investment of proceeds of municipal securities or municipal escrow investments.<sup>164</sup> Next, the MSRB explained that advising with respect to the investment of municipal bond proceeds or municipal escrow investments falls under the municipal advisor regulatory regime only if no exclusion or exemption is available. The MSRB stated:

If the firm is an investment adviser registered under the Advisers Act, the giving of investment advice on the investment of proceeds of municipal securities and municipal escrow investments can be excluded. If the municipal entity makes a qualifying request for proposals (“RFP”) or request for qualifications (“RFQ”) on the investment of proceeds of municipal securities or on municipal escrow investments, or a qualifying mini-RFP or mini-RFQ, the giving of advice in response can be exempt. If the municipal entity relies on the advice of an independent registered municipal advisor (“IRMA”) with respect to the same aspects of the investment of proceeds of municipal securities or municipal escrow investments, the firm’s giving of advice can be exempt, subject to certain procedural requirements. Additionally, if a firm selling investments provides general information but no SEC-defined “advice,” then the firm need not rely on any exclusion or exemption at all.<sup>165</sup>

The MSRB explained that it is generally only beyond all of these scenarios that a firm could be subject to Proposed Rule G–42 and the principal transaction ban based on the providing

of advice on the investment of bond proceeds or municipal escrow investments.

The MSRB further responded to commenters’ concerns by stating that it crafted the Exception to the principal transaction ban drawing on Section 206(3) of the Advisers Act<sup>166</sup> and the IA Rule. The MSRB explained that its approach was influenced by a number of considerations, and stated that highly important among them were the recurring urgings by commenters during the development of Proposed Rule G–42 that the MSRB look to the regulatory regime applicable to investment advisers that provides such advisers the ability to engage in principal transactions with their clients, subject to requirements that include providing full disclosure and obtaining informed consent. The MSRB also noted that the IA Rule has been consistently considered by representatives of the industry, including SIFMA, to be operating as intended, well protecting investors, and extensively relied upon.

GFOA expressed a concern that the procedural requirements of the Exception would be too complex or burdensome and render the relief intended to be granted “illusory.”<sup>167</sup> GFOA stated that this has proved to be the case with similar requirements that apply to principal transactions by investment advisers. GFOA acknowledged, however, that in some respects it would “need feedback from dealers before reaching [a] conclusion” regarding the workability of the Exception, recognizing that its members are, of course, not broker-dealers.

In response to GFOA’s comments, the MSRB stated that it is clear from repeated commentary by representatives of broker-dealers and supporting data, that similar provisions for investment advisers have been manageable and relied upon extensively, providing an ample basis to believe that the similar approach in proposed paragraph .14(d)(2) of the Supplementary Material will be useful and workable for a significant portion of those firms that wish to use an option under the Exception.

GFOA asked whether the consent required to be obtained under proposed paragraph .14(d)(1) of the Supplementary Material may be oral as opposed to written. The MSRB responded that oral consent would be sufficient under proposed paragraph .14(d)(1).<sup>168</sup>

GFOA also asked whether certain communications that would be required to be made in writing under the Exception may be made through email. In response, the MSRB stated that such communications may be made by email, provided the municipal advisor satisfies the same procedural conditions that the SEC applies to an investment adviser when communicating with customers via email as set forth in SEC guidance regarding the use of electronic media.<sup>169</sup>

GFOA asked whether a broker-dealer that has provided advice to a municipal entity based on one of the exclusions or exemptions to the definition of “municipal advisor” (e.g., the underwriter exclusion) would be able to sell investments of bond proceeds to that municipal entity as principal, assuming that the requirements of proposed paragraph .14 are met. The MSRB stated that it assumes that, although not stated explicitly by GFOA, the firm in this scenario also would be providing advice on the investment of bond proceeds, without the availability of an exclusion or exemption for that advice. Otherwise, as the MSRB explained, the firm would not be a municipal advisor to the municipal entity and subject to Rule G–42 and the principal transaction ban. A firm in this scenario would not be specifically prohibited by the principal transaction ban from selling investments of bonds proceeds to a municipal entity as principal, assuming all of the limitations and conditions of proposed paragraph .14 are met.

GFOA asked why a broker-dealer that is a municipal advisor must, under MSRB Rule G–3,<sup>170</sup> pass the municipal advisor representative professional qualifications examination (Series 50) to sell “Treasuries, agencies, and corporate debt securities when bond proceeds are invested, while the Series 7 suffices for the same broker to sell the same securities to a municipal entity when the funds invested are not bond proceeds.” In response to this question, the MSRB explained the definition of “municipal advisor” in the SEC Final Rule and recounted the purpose of the

<sup>169</sup> See *id.* (citing Securities Act Release No. 7288 (May 9, 1996), 61 FR 24644 (May 15, 1996), SEC Interpretation of Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information (listing Section 206(3) as a provision to which the interpretation applies), available at: <https://www.sec.gov/rules/interp/33-7288.txt>).

<sup>170</sup> MSRB Rule G–3(d)(ii)(A) provides that: “Every municipal advisor representative shall take and pass the Municipal Advisor Representative Qualification Examination [(also known as the Series 50 Examination)] prior to being qualified as a municipal advisor representative. The passing grade shall be determined by the Board.”

<sup>163</sup> See BDA letter dated December 1, 2015.

<sup>164</sup> See December Response Letter.

<sup>165</sup> See *id.* (citations omitted).

<sup>166</sup> 15 U.S.C. 80b–6(3).

<sup>167</sup> See GFOA letter dated December 1, 2015.

<sup>168</sup> See December Response Letter.

rulemaking on Rule G–3, on professional qualification requirements.<sup>171</sup>

In response to Amendment No. 2, SIFMA expressed a concern that the Exception would be available, according to proposed paragraph .14(a) of the Supplementary Material, only to a firm that is a registered broker-dealer and only for accounts subject to the Exchange Act, and the rules thereunder, and the rules of self-regulatory organization(s) of which it is a member.<sup>172</sup> SIFMA stated that the registration requirement is “unnecessary” and that the policy rationale for requiring the relevant account to be subject to Exchange Act regulation is “unclear.” SIFMA recognized that the SEC included these same requirements in the IA Rule, but commented that these requirements only exist in that rule due to the historical context in which the decision in *Financial Planning Association v. SEC* (“FPA”) <sup>173</sup> effectively required certain brokerage accounts to be treated as advisory accounts. SIFMA suggested that the Exception should be available to a firm that relies on an exemption from broker-dealer registration, such as a bank. In response to SIFMA’s comment, the MSRB stated that the SEC’s adopting release for the IA Rule indicates that, although historical context gave the SEC occasion to consider the IA Rule, the SEC also explained that:

[A] principal consideration in including the requirements was that broker-dealers and their employees “must comply with the comprehensive set of Commission and self-regulatory organization sales practice and best execution rules that apply to the relationship between a broker-dealer and its customer . . . .”<sup>174</sup>

The MSRB stated that it similarly considers it necessary that transactions

in reliance on the Exception be executed under this comprehensive set of investor protections. In response to SIFMA’s concern regarding banks, the MSRB notes that the SEC has provided an exemption from the municipal advisor definition for banks providing advice on multiple subjects, which could mean that a bank engaging in particular principal transactions would not be subject to Proposed Rule G–42 at all.

FSI and SIFMA expressed concerns regarding the requirement, as part of the option under proposed paragraph .14(d)(2), that the municipal advisor provide its client with an annual summary statement.<sup>175</sup> SIFMA commented that the annual disclosure requirement and the special confirmation disclosure requirements are unwieldy and duplicative.<sup>176</sup> SIFMA also commented that both of these would require firms to implement costly operational changes. SIFMA further commented that it is unclear that municipal entity clients would benefit from these disclosures, having previously provided (and not having revoked) their consent to principal transactions, and receiving the ordinary confirmation disclosure required under Exchange Act Rule 10b-10 that would disclose the capacity in which the broker-dealer acted.

The MSRB first noted that a municipal advisor that considers the alternative provided under proposed paragraph .14(d)(1) comparatively more cost-effective, may make transaction-by-transaction written disclosure and obtain written or oral consent under that provision and not be subject to the additional procedural requirements under proposed paragraph.14(d)(2) to make use of the Exception.<sup>177</sup> Second, the MSRB explained that the annual summary statement requirement is designed to ensure that clients receive a periodic record of the principal trading activity in their accounts and are afforded an opportunity to assess the frequency with which their adviser engages in such trades. It stated that when the requirement was adopted as part of the IA Rule in 2007, the concept of an annual summary of transactions involving particular conflicts of interest was not novel, as it was derived from the cross-trade rule under the Advisers Act. The MSRB stated its belief that an annual summary of all principal transactions, which are executed subject to conflicts of interest where certain

disclosures have been made and consents obtained, would be particularly beneficial to officials of municipal entities, including newly elected or appointed officials who, upon their election or appointment, may be required to review thoroughly and expeditiously the municipal entity’s prior transactions and relationships with financial intermediaries to determine whether the same course with the same intermediaries should continue.

The MSRB also responded that the confirmation disclosure requirement, like the similar requirement under the IA Rule, is designed to ensure that clients are given a written notice and reminder of each transaction that the municipal advisor effects on a principal basis and that conflicts of interest are inherent in such transactions. The MSRB explained that, like under the IA Rule, a firm relying on proposed paragraph .14(d)(2) need not send a duplicate confirmation and may include additional required disclosures on a confirmation otherwise sent to a customer with respect to a particular principal transaction.

BDA commented that the option under proposed paragraph .14(d)(2) would not be meaningful or useful in part because, under proposed paragraph.14(d)(2)(A), neither the firm nor any affiliate would be permitted to be, at the time of a sale, an underwriter of the security.<sup>178</sup> The MSRB responded that it believes this is an important municipal entity protection measure in scenarios where the municipal advisor is not making transaction-by-transaction written disclosure.<sup>179</sup>

SIFMA and FSI objected to the exclusion from the Exception of transactions in connection with municipal escrow investments, and suggested that the Exception be extended.<sup>180</sup> The MSRB explained that the Exception does not so extend because the MSRB believes this is an area of heightened risk where, historically, significant abuses have occurred.<sup>181</sup>

SIFMA commented that the Exception should extend to the purchase and sale of money market instruments, commercial paper, certificates of deposit and other deposit instruments.<sup>182</sup> In SIFMA’s view, there is no municipal entity protection reason to exclude them. Similarly, Spencer Wright

<sup>171</sup> See December Response Letter.

<sup>172</sup> See SIFMA letter dated December 1, 2015.

<sup>173</sup> *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007).

<sup>174</sup> See December Response Letter (citing Advisers Act Release No. 2653 (September 24, 2007), at 28, 72 FR 55022, at 55029 (September 28, 2007) (Temporary Rule Regarding Principal Trades with Certain Advisory Clients); see also Advisers Act Release No. 3128 (December 28, 2010), at 22, 75 FR 82236, at 82241 (December 30, 2010) (Temporary Rule Regarding Principal Trades with Certain Advisory Clients) (“The condition that advisers seeking to rely on the rule must also be registered as broker-dealers and that each account with respect to which an adviser seeks to rely on the rule must be a brokerage account subject to the Exchange Act, and the rules thereunder, and the rules of the self-regulatory organization(s) of which it is a member, reflect what we believe is an important element of our balancing between easing regulatory burdens (by affording advisers an alternative means of compliance with section 206(3) of the Act) and meeting our investor protection objectives.”)).

<sup>175</sup> See letters from FSI dated December 1, 2015 and SIFMA dated December 1, 2015.

<sup>176</sup> See SIFMA letter dated December 1, 2015.

<sup>177</sup> See December Response Letter.

<sup>178</sup> See BDA letter dated December 1, 2015.

<sup>179</sup> See December Response Letter.

<sup>180</sup> See letters from FSI dated December 1, 2015 and SIFMA dated December 1, 2015.

<sup>181</sup> See December Response Letter.

<sup>182</sup> See SIFMA letter dated December 1, 2015.

commented that a ban on offering money market securities would adversely affect governments and limit their investment choices.<sup>183</sup>

The MSRB responded that the designated class of securities for purposes of the Exception is intended to address comments previously submitted that an absolute ban on principal transactions in fixed income securities, which are frequently sold by broker-dealers as principal or riskless principal, would be particularly problematic and such a ban would impose a substantial burden on municipal entities.<sup>184</sup> The MSRB also explained that municipal entities seeking to purchase or sell money market instruments and receive related advice would have sufficient access and flexibility to choose among various providers. In addition, the MSRB stated that it limited the fixed income securities for which the Exception is available to generally relatively liquid fixed income securities trading in relatively transparent markets, in order to raise significantly less risk for municipal entity clients. The MSRB does not believe it is appropriate to amend it to include this group of fixed income securities prior to implementing the Exception and reviewing its impact on the market.

SIFMA commented that it was unclear whether the Exception would extend to the affiliates of a municipal advisor, and that there does not appear to be any reason to permit a municipal advisor (if also a broker-dealer) to benefit from the Exception, and not similarly allow an affiliate (if also a broker-dealer, or if exempt from registration as a broker-dealer) to benefit from the Exception.<sup>185</sup> In response, the MSRB stated that the language of proposed paragraph .14 of the Supplementary Material makes clear that the use of the Exception would be limited to the municipal advisor and would not extend to its affiliates.<sup>186</sup> The MSRB explained that the Exception was designed to provide municipal entities access to services from known financial intermediaries with whom they have a relationship, and simultaneously to address and mitigate certain conflicts of interest when a single entity would provide advice that constitutes municipal advisory activity to its municipal entity client and also engage

in a principal transaction with such client.

SIFMA, in response to Amendment No. 2, commented that it would be impractical for a firm relying on the Exception to comply with the conflicts disclosure and relationship documentation requirements of proposed sections (b) and (c), particularly on a transaction-by-transaction basis.<sup>187</sup> In response, the MSRB stated that the duties and obligations of a municipal advisor under Proposed Rule G-42 regarding the disclosures of conflicts of interest and other information and municipal advisory relationship documentation should not be waived or diminished because a municipal advisor uses the Exception under proposed paragraph .14.<sup>188</sup> The MSRB further explained that the ban, to which the Exception relates, only would apply in the case of clients that are municipal entities, meaning the disclosures and documentation at issue will always be in support of the fulfillment of a fiduciary duty. In addition, the MSRB stated that the proposed requirements under proposed sections (b) and (c) to provide disclosure of conflicts of interest and other information to a client and document the municipal advisory relationship, respectively, are separate and distinct requirements from the disclosures and consent conditions in proposed paragraph .14.

#### *L. Consistency With Statutory Standards*

In response to Amendment No. 1 or the OIP, several commenters expressed the view that the proposed rule change was inconsistent with certain provisions of the Exchange Act.<sup>189</sup> Cooperman, NAMA and SIFMA commented that the proposed rule change is inconsistent with Section 15B(b)(2)(L)(iv) of the Exchange Act,<sup>190</sup> which requires that the MSRB not impose a regulatory burden on small municipal advisors that is not necessary or appropriate in the public interest and for the protection of investors, and municipal entities, provided that there is robust protection against fraud. Cooperman suggested that the MSRB could ease the burden on smaller municipal advisors by providing more specific guidance as to the scope of the requirements and restrictions in the proposed rule change. NAMA believed that as a result of the proposed rule change, municipal advisors would have to devote significant time and

resources to establish procedures to comply with what it termed “vague and broad” rules. In NAMA’s view this will be particularly burdensome for smaller municipal advisors. SIFMA also commented that municipal entity clients (in particular small municipal entity clients) would be acutely and adversely affected by the proposed rule change because, in its view, the number of municipal advisors with which the municipal entity could engage would be limited to the point that the municipal entity would not have adequate access to a municipal advisor or would only have the requisite access at an unnecessarily high cost to the municipal entity client.

In response to Amendment No. 2, NAMA subsequently commented that it “supports the current proposed Rule and urges the SEC to approve it in its current form without further erosion of the important principal transaction ban that is in place to protect investors.”<sup>191</sup>

In response to Amendment No. 1 or the OIP, SIFMA stated that Proposed Rule G-42 was inconsistent with Section 15B(b)(2)(C) of the Exchange Act<sup>192</sup> as to the requirement that an MSRB rule not “impose any burden on competition not necessary or appropriate.”<sup>193</sup> In its view, the proposed rule change is overly burdensome, overly broad, introduces unnecessary costs, and would lead to an inappropriate reduction in competition in the municipal advisory marketplace. In addition, SIFMA indicated that it has observed municipal advisors exiting the municipal advisory business in anticipation of the implementation of the proposed rule change and that this has already resulted in reduced competition in the municipal advisory industry. SIFMA stated that the proposed rule change, in its view, would result in less competition in the municipal advisory industry, increased costs to issuers and fewer services available to issuers of municipal securities. SIFMA also commented that the MSRB could “achieve the same objectives without burdening competition” by revising Proposed Rule G-42 consistent with SIFMA’s prior comments.

In response to Amendment No. 1 or the OIP, Cooperman, GFOA, ICI and SIFMA questioned the adequacy of the MSRB’s economic analysis of the proposed rule change.<sup>194</sup> Cooperman

<sup>183</sup> See Spencer Wright letter dated December 16, 2015.

<sup>184</sup> See December Response Letter.

<sup>185</sup> See SIFMA letter dated December 1, 2015.

<sup>186</sup> See December Response Letter.

<sup>187</sup> See SIFMA letter dated December 1, 2015.

<sup>188</sup> See December Response Letter.

<sup>189</sup> See letters from Cooperman dated September 9, 2015; NAMA dated September 11, 2015; and SIFMA dated September 11, 2015.

<sup>190</sup> See 15 U.S.C. 78o-4(b)(2)(L)(iv).

<sup>191</sup> See NAMA letter dated December 7, 2015.

<sup>192</sup> See 15 U.S.C. 78o-4(b)(2)(C).

<sup>193</sup> See SIFMA letter dated September 11, 2015.

<sup>194</sup> See letters from Cooperman dated September 9, 2015; GFOA dated September 14, 2015; ICI dated

believed that the MSRB did not follow its own policy to conduct an economic analysis with respect to Proposed Rule G–42. Cooperman also believed that the MSRB did not gather data on the economic impact of the regulatory regime under Proposed Rule G–42. Rather, according to Cooperman, the MSRB reached its conclusions based on “unsubstantiated broad brush economic consequences.”<sup>195</sup> GFOA and SIFMA similarly stated their views that the MSRB provided no economic analysis in concluding that the benefits of Proposed Rule G–42 outweigh the potential costs. ICI commented that the MSRB failed to analyze the potential economic impact of, and asked if there were an unreasonable or unnecessary burden in connection with, the proposed requirement that a municipal advisor undertake a reasonable investigation to determine that it is not basing any recommendation on materially inaccurate or incomplete information, which includes information provided by the municipal advisor’s client.

In response to the comments regarding the MSRB’s economic analysis, the MSRB noted in its December Response Letter that throughout the development of the proposed rule change the MSRB rigorously followed its Policy on the Use of Economic Analysis in MSRB Rulemaking (“MSRB Policy”).<sup>196</sup> In particular, the MSRB stated that it sought relevant data from industry participants and commenters on multiple occasions in accordance with the MSRB Policy’s reference to the SEC’s Current Guidance on Economic Analysis in SEC Rulemakings (“SEC Guidance”),<sup>197</sup> which “stresses the need to *attempt* to quantify anticipated costs and benefits . . .” (emphasis added) but notes that “data is necessary” to do so. Despite these requests, the MSRB stated that it received no data—imperfect or otherwise—or other information, which would support any additional quantification of the impact of the proposed rule change. In the proposed rule change, the MSRB noted this lack of data to explain why further quantification could not be

supported.<sup>198</sup> In the absence of relevant data, consistent with the MSRB Policy and SEC Guidance, the MSRB noted that it conducted a qualitative evaluation of the benefits and costs of the proposed rule change based significantly on the SEC’s analysis of the municipal advisor market included in the SEC’s Final Rule.<sup>199</sup> In its analysis, the MSRB concluded that the market for municipal advisors likely would remain competitive despite the potential exit of some municipal advisors (including small entity municipal advisors), consolidation of municipal advisors or lack of new entrants into the market.

The MSRB believes that commenters’ observations that, as a result of the proposed rule change, some municipal advisors may have exited the market and some issuers may be experiencing less competition do not provide a basis for revising the MSRB’s prior assessments of the potential impacts of the proposed rule change for several reasons.<sup>200</sup> First, commenters have not provided data to support their observations. Second, to the extent municipal advisors have exited the market, commenters have not provided evidence to support a conclusion that they have done so in anticipation of a proposed rule change rather than, for example, in reaction to the Dodd-Frank Act itself, the subsequent registration requirements, or the professional qualification requirements, all of which were properly included in the baseline against which the impacts of the proposed rule change were assessed. Finally, the commenters have not provided evidence that the exit of any municipal advisor has in fact decreased competition, increased cost or resulted in reduced advisory services.

With regard to the impact of the proposed rule change on small municipal advisors, the MSRB discussed the potential burdens on smaller advisory firms at length and concluded that the likely costs represented only those necessary to achieve the purposes of the Exchange Act.<sup>201</sup> The MSRB is not aware of alternatives—and commenters have not proposed any—that would reduce the burden on small municipal advisor firms while achieving the same regulatory objectives, including what the MSRB believes is the appropriate

balance between principles-based provisions and more specifically prescriptive provisions.

Also in response to Amendment No. 1 or the OIP, several commenters indicated their view that the proposed rule change was inconsistent with the Exchange Act in connection with the principal transaction ban if such ban remained as proposed, without any exceptions or modifications. The MSRB, in Amendment No. 2, addressed the primary concerns by adding the Exception. The MSRB believes that the Exception is responsive to the commenters’ concerns that, in connection with the proposed ban, Proposed Rule G–42 is inconsistent with the Exchange Act.<sup>202</sup>

#### *M. Relationship Between MSRB Rule G–23 and the Prohibition on Principal Transactions*

In response to the Proposing Release, BDA and NAMA stated that the reference to MSRB Rule G–23 in paragraph .08 of the Supplementary Material was unnecessary or enhances the possible conflict between Proposed Rule G–42 and Rule G–23.<sup>203</sup> BDA interpreted the prohibition in Rule G–23 as subsumed by the more stringent provisions of Proposed Rule G–42.<sup>204</sup> NAMA believed the additional activities or principal transactions that should be prohibited under Proposed Rule G–42 (namely advice with respect to municipal derivatives or the investment of proceeds) don’t conflict with Rule G–23, but merely supplement the prohibitions in Rule G–23 by extending the list of prohibitions found in Rule G–23.<sup>205</sup>

In response to comments, the MSRB stated that the effect of the final sentence in proposed paragraph .08 is intentionally quite limited.<sup>206</sup> The MSRB clarified that as to a person acting in compliance with Rule G–23, the final sentence in proposed paragraph .08 provides an exception, but only to the specific prohibition on principal transactions in Proposed Rule G–42(e)(ii). The MSRB stated that proposed subsection (e)(ii) would not

<sup>202</sup> See letters from BDA dated September 11, 2015; FSI dated September 11, 2015; Millar Jiles dated September 11, 2015; SIFMA dated September 11, 2015; and Zions dated September 10, 2015, containing statements that the Proposed Rule, with the proposed principal transaction ban, is inconsistent with one or more of the following Exchange Act provisions: Section 15B(b)(2)(L); Section 15B(b)(2)(L)(i); Section 15B(b)(2)(C); and Section 3(f).

<sup>203</sup> See letters from BDA dated May 29, 2015 and NAMA dated May 29, 2015.

<sup>204</sup> See BDA letter dated May 29, 2015.

<sup>205</sup> See NAMA letter dated May 29, 2015.

<sup>206</sup> See August Response Letter.

September 11, 2015; and SIFMA dated September 11, 2015.

<sup>195</sup> See Cooperman letter dated September 9, 2015.

<sup>196</sup> See MSRB, Policy on the Use of Economic Analysis in MSRB Rulemaking, <http://msrb.org/About-MSRB/Financial-and-Other-Information/Financial-Policies/Economic-Analysis-Policy.aspx>.

<sup>197</sup> See SEC Memorandum Re: Current Guidance on Economic Analysis in SEC Rulemakings (dated March 16, 2012), [https://www.sec.gov/divisions/riskfin/rsfi\\_guidance\\_econ\\_analy\\_secrulemaking.pdf](https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf).

<sup>198</sup> See Proposing Release, 80 FR 26752, at 26784 (“No commenter provided specific cost information or data that would support an improved estimate of the costs of compliance.”).

<sup>199</sup> See SEC Final Rule, 78 FR 67467, at 67608.

<sup>200</sup> See December Response Letter.

<sup>201</sup> See Proposing Release, 80 FR 26752, at 26759–60 (statement on burden on competition); see also *id.* at 26784–85 (economic analysis).

prohibit a type of principal transaction that is already addressed and prohibited, to a certain extent, under Rule G–23, although other provisions of Rule G–42 must be considered as they do apply to the same principal transaction.

In response to Amendment No. 1 or the OIP, NAMA reiterated its comments that the reference to Rule G–23 should be deleted from proposed paragraph .08 because the MSRB’s statements regarding that provision in its August Response Letter were unnecessarily complicated.<sup>207</sup> In addition, NAMA believed such statements raise a question that the MSRB may believe that conduct permitted by Rule G–23 would be otherwise prohibited by Proposed Rule G–42 (apart from Proposed Rule G–42(e)(ii)).

In response to NAMA’s comments, the MSRB reiterated its earlier response regarding the limited effect of the reference to G–23 in paragraph .08 of the Supplementary Material.<sup>208</sup> The MSRB explained that where certain conduct is not prohibited under Rule G–23 (as an exception to the general prohibition therein), Proposed Rule G–42(e)(ii) (the principal transaction provision) alone would not prohibit such conduct. The MSRB stated that nevertheless, other parts of Proposed Rule G–42 and statutory provisions must be considered to determine whether the conduct, although not prohibited by Rule G–23 and not specifically prohibited under Proposed Rule G–42(e)(ii), would violate another provision of Proposed Rule G–42 or other applicable MSRB rules or other applicable laws or regulations.<sup>209</sup> In this respect, the type of principal transaction excepted by the final sentence of paragraph .08 from Proposed Rule G–42(e)(ii) is no different than any other principal transaction that is not specifically prohibited by subsection (e)(ii). The MSRB restated that merely because a principal transaction is not specifically prohibited by the principal transaction ban does not necessarily mean it is permitted.

#### *N. Request for Prospective Application of Proposed Rule G–42 Requirements*

ICI and SIFMA requested the proposed rule change only apply prospectively to municipal advisory relationships entered into, or recommendations of municipal securities transactions or municipal financial products to an existing

municipal entity or obligated person client made, after the effective date of the proposed rule change.<sup>210</sup> ICI noted this was relevant with respect to 529 plans “due to the nature of the advisor’s relationship with the plan and duration of existing 529 plan contracts.”<sup>211</sup> SIFMA argued that reviewing and likely supplementing the documentation for all existing municipal advisory relationships will be overly burdensome for both municipal advisors and their clients.<sup>212</sup>

The MSRB responded that the proposed rule would not require the creation of new contractual relationships or the modification of existing contracts or agreements between municipal advisors and their clients when the rule takes effect.<sup>213</sup> It clarified that if municipal advisors have already delivered documentation meeting some or all of the requirements of proposed section (c), on documentation of municipal advisory relationship, then municipal advisors would be able to rely on such documents to satisfy some or all of their obligations under section (c). The MSRB also stated that documents in place prior to the effective date that are in some way deficient are not required to be withdrawn but may be supplemented by the municipal advisor by the delivery of additional documentation that satisfies any remaining requirements of the proposed rule. The MSRB also clarified that requirements of section (d), on recommendations and review of recommendations of other parties, would apply only to recommendations made or reviewed after the proposed rule change becomes effective. Finally, the MSRB stated that municipal advisors will become subject to the applicable standards of conduct with regard to all of their municipal advisory activities, regardless of whether the relevant engagement began prior to the effective date of the rule.

In response to Amendment No. 1 or the OIP, ICI reiterated its comment that the proposed rule should only apply prospectively when a municipal advisor either enters into a new advisory relationship with a municipal client or when it recommends a new municipal securities transaction or new municipal financial product to an existing municipal client.<sup>214</sup> ICI recommended that the MSRB further clarify “how each of the new obligations the rule and its

Supplementary Material impose on municipal advisors will apply to existing contracts, relationships, and municipal advisory activities.”

The MSRB responded stating that all provisions of the proposed rule would, if approved, apply only prospectively.<sup>215</sup> As previously stated by the MSRB, the requirements of the proposed rule, including its Supplementary Material, would apply prospectively to any activity that is within the definition in the proposed rule of “municipal advisory activities” if that activity is engaged in on or after the date of implementation (the “effective date”) of Rule G–42. The MSRB further clarified that the proposed rule will apply to all municipal advisory relationships that are in existence on or after the effective date, regardless of when a municipal advisor and client may have entered into a particular relationship. The MSRB also noted that in accordance with MSRB Rule G–44 (Supervisory and Compliance Obligations of Municipal Advisors), which is currently in effect, on the effective date of Rule G–42, if approved, each municipal advisor would be required to have established written supervisory procedures reasonably designed to ensure that the municipal advisor and its associated persons are in compliance with Rule G–42 on and after its effective date.

#### *O. Use of Supplementary Material in Proposed Rule G–42*

PFM suggested that all supplementary material be removed and moved to separate written interpretative guidance to afford the subjects more “fittingly robust regulatory guidance.”<sup>216</sup> PFM was concerned that the supplementary material which does not allow for “more succinct definitional direction” would lead to inconsistent application by registrants and “the potential for unintended consequences as a matter of the statute itself.” In response to the comment, the MSRB stated that the structure of the proposed rule is intentionally consistent with the structure used by FINRA and other self-regulatory organizations and the MSRB has not to date observed the types of issues or concerns raised by PFM.<sup>217</sup>

#### **IV. Discussion and Commission Findings**

The Commission has carefully considered the proposed rule change, as modified by Amendment No. 1 and Amendment No. 2, as well as the

<sup>210</sup> See letters from ICI dated May 29, 2015 and SIFMA dated May 28, 2015.

<sup>211</sup> See ICI letter dated May 29, 2015.

<sup>212</sup> See SIFMA letter dated May 28, 2015.

<sup>213</sup> See August Response Letter.

<sup>214</sup> See ICI letter dated September 11, 2015.

<sup>215</sup> See December Response Letter.

<sup>216</sup> See PFM letter dated May 29, 2015.

<sup>217</sup> See August Response Letter.

<sup>207</sup> See NAMA letter dated September 11, 2015.

<sup>208</sup> See December Response Letter.

<sup>209</sup> See Proposing Release, 80 FR 26752, at 26782–83; see also August Response Letter.



comment letters received and the MSRB Response Letters. The Commission finds that the proposed rule change, as amended by Amendment No. 1 and Amendment No. 2, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the MSRB.

In particular, the proposed rule change, as amended, is consistent with Sections 15B(b)(2), 15B(b)(2)(C), and 15B(b)(2)(L)(i) of the Act. Section 15B(b)(2) of the Act provides that the MSRB shall propose and adopt rules to effect the purposes of that 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.<sup>218</sup> Section 15B(b)(2)(C) of the Act requires that the MSRB's rules 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.<sup>219</sup> Section 15B(b)(2)(L)(i) of the Act requires, with respect to municipal advisors, the MSRB to prescribe means reasonably designed to prevent acts, practices, and courses of business as are not consistent with a municipal advisor's fiduciary duty to its clients.<sup>220</sup>

The proposed rule change, as amended, is consistent with Sections 15B(b)(2), 15B(b)(2)(C), and 15B(b)(2)(L)(i) of the Act because it establishes standards of conduct and duties for municipal advisors when engaging in municipal advisory activities. Specifically, the proposed rule change provides that each municipal advisor in the conduct of its municipal advisory activities for an obligated person client is subject to a duty of care. The proposed rule change

also provides that each municipal advisor to a municipal entity client is subject to a fiduciary duty that includes a duty of loyalty and a duty of care. Paragraphs .01 and .02 of the Supplementary Material provide guidance on the duty of care and the duty of loyalty, respectively, to assist municipal advisors in complying with such duties. In addition, the proposed rule change includes means to help prevent breaches of these duties by municipal advisors, including the requirements for the information that must be included in the documentation of the municipal advisory relationship; specified activities (such as certain principal transactions and excessive compensation) that would be explicitly prohibited; and disclosure requirements that must accompany a municipal advisor's recommendation regarding a municipal security or a municipal financial product. The Commission believes these requirements are reasonably designed to prevent acts, practices and courses of business as are not consistent with a municipal advisor's fiduciary duty.

The proposed rule change, as amended, would help protect municipal entities and obligated persons by promoting higher ethical and professional standards of the municipal advisors they employ to assist with issuances of municipal securities and transactions in municipal financial products. By requiring municipal advisors to provide detailed disclosures of material conflicts of interest and certain other information prior to or upon the establishment of the municipal advisory relationship, the proposed rule change will help ensure municipal entity and obligated person clients have access to sufficient information to make meaningful choices, based on the merits of the municipal advisor. The Commission believes the disclosure requirements also could incentivize municipal advisors not to engage in misconduct.<sup>221</sup> In addition, the suitability requirements in section (d) of the proposed rule and the related Supplementary Material will help protect municipal entities and obligated persons from the potentially costly consequences of transactions undertaken based on unsuitable recommendations. The proposed amendments to Rule G-8(h) will assist in the enforcement of Proposed Rule G-42 and will allow organizations that

examine municipal advisors to more precisely monitor and promote compliance with the proposed rule change.

The Commission also finds that the proposed rule change, as amended, is consistent with Section 15B(b)(2)(L)(iv) of the Act, in that it does not impose a regulatory burden on small municipal advisors that is not necessary or appropriate in the public interest and for the protection of investors, municipal entities, and obligated persons, provided that there is robust protection of investors against fraud.<sup>222</sup> While the proposed rule change would affect all municipal advisors, including small municipal advisors, it is a necessary and appropriate regulatory burden in order to promote compliance with the fiduciary duty and the duty of care. Municipal entities and obligated persons will have access to more information about municipal advisors and will be able to make better, more informed choices with lower search costs. The availability of additional, objective information and the fostering of merit-based competition among municipal advisors should lead to enhanced issuer protections and improved outcomes. These improvements likely would enhance investor confidence in the integrity of the municipal securities market. While the proposed rule change would burden some small municipal advisors, the Commission believes that such burden is outweighed by these benefits. In addition, the proposed rule change will provide a benefit to all municipal advisors, including small municipal advisors, that could otherwise face uncertainty regarding the duties and standards of conduct required in order to comply with the relevant provisions of the Exchange Act.

In addition, the Commission finds that the proposed rule change, as amended, is consistent with Section 15B(b)(2)(G) of the Act which provides that the MSRB's rules shall prescribe records to be made and kept by municipal advisors and the periods for which such records shall be preserved.<sup>223</sup> The proposed rule change, through the proposed amendments to Rule G-8(h), would require that a municipal advisor make and keep records of any document created by the municipal advisor that was material to its review of a recommendation by another party or that memorializes the basis for any determination as to suitability. Existing Rule G-9(h) would require that the books and records

<sup>221</sup> See also SEC Final Rule, 78 FR 67467, at 67602, 67606, 67618 and 67622 (discussing the disclosure requirements of the municipal advisor registration regime and incentives of municipal advisors not to engage in misconduct).

<sup>222</sup> See 15 U.S.C. 78o-4(b)(2)(L)(iv).

<sup>223</sup> See 15 U.S.C. 78o-4(b)(2)(G).

<sup>218</sup> 15 U.S.C. 78o-4(b)(2).

<sup>219</sup> See 15 U.S.C. 78o-4(b)(2)(C).

<sup>220</sup> 15 U.S.C. 78o-4(b)(2)(L)(i).

required by the proposed rule change be preserved for a period of not less than five years.

In approving the proposed rule change, as amended, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation.<sup>224</sup> The Commission believes the proposed rule change takes into account competitive concerns that could arise as a result of the costs associated with complying with the standards of conduct and duties that could lead some municipal advisors to exit the market, curtail their activities or consolidate with other firms. The MSRB has made efforts to minimize costs in response to commenters including: (i) Narrowing the scope of the conflicts that must be disclosed, (ii) specifying a less burdensome method for disclosing conflicts and disciplinary actions and documenting the municipal advisory relationship, (iii) clarifying the obligations owed by municipal advisors to obligated persons, (iv) including a limited safe harbor to relieve municipal advisors that inadvertently engage in municipal advisory activities from compliance with section (b) of Proposed Rule G-42, on disclosure of conflicts of interest and other information, and section (c) of Proposed Rule G-42, on documentation of the municipal advisory relationship, and (v) allowing certain municipal advisors to engage in principal transactions in a range of fixed income securities for the investment of bond proceeds. Moreover, the Commission continues to believe "that the market for municipal advisory services is likely to remain competitive despite the potential exit of municipal advisors, consolidation of municipal advisors, or lack of new entrants into the market."<sup>225</sup>

As noted above, the Commission received 35 comment letters on the filing. The Commission believes that the MSRB, through its responses and through proposed changes in Amendment No. 1 and Amendment No. 2, has addressed commenters' concerns.

For the reasons noted above, including those discussed in the MSRB Response Letters, the

Commission believes that the proposed rule change, as amended by Amendment No. 1 and Amendment No. 2, is consistent with the Act.

## V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>226</sup> that the proposed rule change (SR-MSRB-2015-

03), as modified by Amendment No. 1 and Amendment No. 2, be, and hereby is, approved.

For the Commission, pursuant to delegated authority.<sup>227</sup>

**Brent J. Fields,**

*Secretary.*

[FR Doc. 2015-32812 Filed 12-29-15; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-76756; File No. SR-EDGX-2015-66]

### Self-Regulatory Organizations; EDGX Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Proprietary Trader and Proprietary Trader Principal Registration Categories, Securities Trader and Securities Trader Principal Registration Categories, and Establishing the Series 57 Examination

December 23, 2015.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 22, 2015, EDGX Exchange, Inc. (the "Exchange" or "EDGX") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange has designated this proposal as a "non-controversial" proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6)(iii) thereunder,<sup>4</sup> which renders it effective upon filing with the Commission. 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 Exchange filed a proposal to retire the Proprietary Trader and Proprietary Trader Principal registration categories and to establish the Securities Trader and Securities Trader Principal registration categories. The Exchange is also amending its rules to establish the Series 57 examination as the appropriate qualification examination for Securities Traders and deleting the rule referring to the S501 continuing education program currently applicable

to Proprietary Traders. The Exchange will announce the effective date of the proposed rule change in a circular distributed to Members.

The text of the proposed rule change is available at the Exchange's Web site at [www.batstrading.com](http://www.batstrading.com), at the principal office of the Exchange, 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 Exchange 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 Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant parts of such statements.

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

###### 1. Purpose

The Exchange is proposing herein to replace the Series 56 with the Series 57 examination and to make various related changes to its registration rules. Specifically, in response to the FINRA Amendments (defined below), the Exchange is proposing to retire the Proprietary Trader<sup>5</sup> registration categories from its own registration rules relating to securities trading activity. It is also therefore retiring its Proprietary Trader Principal<sup>6</sup> registration category. To take the place of the retired registration categories, the Exchange is establishing new Securities Trader and Securities Trader Principal registration categories. This filing is based upon and in response to SR-FINRA-2015-017, which was recently approved by the Commission.<sup>7</sup>

###### New Securities Trader Registration Category

Currently, under Exchange Rule 11.4(e), each person associated with a member who is included within the definition of an "Authorized Trader" in Rule 1.5(d) is required to register with

<sup>5</sup> Rule 2.5, Interpretation and Policy .01(f).

<sup>6</sup> Rule 2.5, Interpretation and Policy .01(d).

<sup>7</sup> See Securities Exchange Act Release No. 75783 (August 28, 2015), 80 FR 53369 (September 3, 2015) (approving SR-FINRA-2015-017) referred to herein as the "FINRA Amendments." According to the release, FINRA's expected effective date for the FINRA Amendments is January 4, 2016.

<sup>227</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>224</sup> 15 U.S.C. 78c(f).

<sup>225</sup> SEC Final Rule, 78 FR 67467, at 67608.

<sup>226</sup> 15 U.S.C. 78s(b)(2).