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SECURITIES AND EXCHANGE COMMISSION

[Release No. 95145; File No. SR-MSRB-2022-02]

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

June 23, 2022.

I. Introduction

On April 29, 2022, the Municipal Securities Rulemaking Board (the "MSRB" or "Board") filed with the Securities and Exchange Commission (the "SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to consisting of amendments to: (i) MSRB Rule G-19, on suitability of recommendations and transactions, and (ii) MSRB Rule G-48, on transactions with sophisticated municipal market professionals ("SMMPs")[3] (collectively, the "proposed rule change").

The proposed rule change would align MSRB Rule G-19 to the Commission's Rule 15l-1 under the Exchange Act ("Regulation Best Interest")[4] for certain municipal securities activities

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1 15 U.S.C. 78s(b)(1).

2 17 CFR § 240.19b-4.

3 Under MSRB Rule D-15, on the term sophisticated municipal market professional, "[t]he term 'sophisticated municipal market professional' or 'SMMP' is generally defined by three essential requirements: the nature of the customer; a determination of sophistication by the broker, dealer or municipal securities dealer []; and an affirmation by the customer; as specified [therein]." See MSRB Rule D-15.

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

of bank dealers[5] (the "Best Interest Amendments"). In addition, the proposed rule change would amend MSRB Rule G-48 to modify the quantitative suitability obligation of brokers, dealers, and municipal securities dealers (collectively, "dealers" and, individually, each a "dealer") by eliminating the quantitative suitability obligation for recommendations in circumstances where a dealer does not have actual control or de facto control over the account of an Institutional SMMP (the "Institutional SMMP Amendment").[6]

The proposed rule change was published for comment in the Federal Register on May 10, 2022.[7] The public comment period closed on May 31, 2022, and no comment letters were received on the proposed rule change. As described further below, the Commission is approving the proposed rule change.

II. Description of Proposed Rule Change

As described further below, the proposed rule change consists of the Best Interest Amendments and the Institutional SMMP Amendment.

A. Background and Purpose of the Best Interest Amendments

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

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

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

7 Exchange Act Release No. 88829 (May 4, 2022) (the "Notice"), 87 FR 28084 (May 12, 2020) (MSRB-2022-02).

recommendations to retail customers of municipal securities transactions or investment strategies involving municipal securities (collectively, "retail municipal recommendations" and, individually, each a "retail municipal recommendation").[8] The MSRB also stated that the Best Interest Amendments are intended to improve investor protection in the municipal securities market by ensuring that retail customers are afforded the investor protections provided by Regulation Best Interest, regardless of whether a retail municipal recommendation received by a retail customer is made by a Broker-Dealer[9] or a Bank Dealer.

B. Background on the Commission's Regulation Best Interest

On June 5, 2019, the SEC adopted Regulation Best Interest, which established a new standard of conduct for broker-dealers, and the natural persons who are associated persons of such broker-dealers (collectively, "Broker-Dealers" and, individually, each a "Broker-Dealer"), when making a recommendation to a retail customer of any securities transaction or investment strategy involving securities.[10] As defined in Regulation Best Interest, the term "retail customer" generally refers to any natural person, or the legal representative of such person, who receives and uses a recommendation from a Broker-Dealer primarily for personal, family, or household purposes.[11] Regulation Best Interest enhanced the Broker-Dealer standard of conduct beyond previously existing suitability obligations, such as those then required by MSRB Rule G-19, on

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8 Notice, 87 FR at 28084.

9 The term "Broker-Dealer" is used here as defined below under the following discussion Background on the Commission's Regulation Best Interest.

10 See, generally, Regulation Best Interest Adopting Release.

11 17 CFR 240.15l-1(b)(1) ("Retail customer means a natural person, or the legal representative of such natural person, who (i) [r]eceives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and (ii) [u]ses the recommendation primarily for personal, family, or household purposes.") For discussion of what it means for a retail customer to "use" a recommendation, see the SEC staff's Frequently Asked Questions on Regulation Best Interest, available at https://www.sec.gov/tm/faq-regulation-best-interest.

suitability, for such retail customers and aligned the applicable standard of conduct with the reasonable expectations of retail customers.[12]

In this regard, Regulation Best Interest imposes the following "general obligation" on Broker-Dealers, stating a broker, dealer, or a natural person who is an associated person of a broker or dealer, when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer, shall act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.[13]

In response to the Commission's adoption of Regulation Best Interest, on May 1, 2020, the MSRB filed a proposed rule change with the Commission to harmonize Regulation Best Interest with certain MSRB rules applicable to related municipal securities activities of Broker-Dealers.[14] The Commission approved these proposed amendments on June 25, 2020.[15]

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

13 17 CFR 240.15l-1(a)(1). Regulation Best Interest provides that this general obligation is satisfied only if a Broker-Dealer complies with four component obligations: (i) an obligation to make certain prescribed disclosures, before or at the time of the recommendation, about the recommendation and the relationship between the retail customer and the Broker-Dealer (the "Disclosure Obligation") (see 17 CFR 240.15l-1(a)(2)(i)); (ii) an obligation to exercise reasonable diligence, care, and skill in making a recommendation (the "Care Obligation") (see 17 CFR 240.15l-1(a)(2)(ii)); (iii) an obligation to establish, maintain, and enforce written policies and procedures reasonably designed to address conflicts of interest (the "Conflict-of-Interest Obligation") (see 17 CFR 240.15l-1(a)(2)(iii)); and (iv) an obligation to establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest (the "Compliance Obligation") (see 17 CFR 240.15l-1(a)(2)(iv)).

14 See Exchange Act Release No. 88828 (May 6, 2020), 85 FR 28082, File No. SR-MSRB-2020-02 (hereinafter, the "Broker-Dealer Harmonization Filing"), available at https://msrb.org/-/media/Files/SEC-Filings/2020/MSRB-2020-02-Notice.ashx?.

15 See Exchange Act Release No. 89154 (June 25, 2020), 85 FR 39613 (July 1, 2020), File No. SR-MSRB-2020-02, available at https://msrb.org/-/media/Files/SEC-Filings/2020/MSRB-2020-02-Federal-Register.ashx?.

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

By its terms, Regulation Best Interest does not apply to retail municipal recommendations made by Bank Dealers, because Bank Dealers in exempted securities have an exception from Broker-Dealer status under the Act and Regulation Best Interest applies only to Broker-Dealers.[16] As a result, Bank Dealers presently are not required to comply with Regulation Best Interest and, therefore, retail investors may not benefit from its enhanced standard of conduct when receiving recommendations from Bank Dealers.[17]

D. Application of Regulation Best Interest to Bank Dealers

The MSRB stated that the proposed Best Interest Amendments would amend MSRB Rule G-19 to require a Bank Dealer to comply with Regulation Best Interest to the same extent as if it were a Broker-Dealer when making a retail municipal recommendation.[18] Consequently, a Bank Dealer would have to act in the best interest of the retail customer at the time a retail municipal recommendation is made,without placing the financial or other interests of the Bank Dealer ahead of the interest of the retail customer.[19] Correspondingly, the Bank Dealer would have to comply with the Commission's component obligations of Regulation Best Interest to the same

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16 Notice, 87 FR at 28085.

17 See Broker-Dealer Harmonization Filing, 85 FR at 28083, n. 5 (discussing how Bank Dealers are not subject to Regulation Best Interest by the terms of the SEC's rules and indicating the Board's intent to issue a request for comment regarding extending the requirements of Regulation Best Interest to Bank Dealers). Notably, all Bank Dealer recommendations, including retail municipal recommendations, are presently subject to the longstanding suitability obligations provided by MSRB rules, including MSRB Rule G-19 and, when applicable, MSRB Rule G-48. Notice, 87 FR at 28085, n. 13.

18 Notice, 87 FR at 28085.

19 Id.

extent as if it were a Broker-Dealer, including Regulation Best Interest's Disclosure Obligation,[20] Care Obligation,[21] Conflict-of-Interest Obligation,[22] and Compliance Obligation.[23]

Under the proposed Best Interest Amendments, the component obligations of Regulation Best Interest would apply to those municipal securities activities associated with a retail municipal recommendation within the overall context of a Bank Dealer business model. The MSRB stated that it believes that any SEC guidance with respect to the understanding and application of Regulation Best Interest would be equally applicable to Bank Dealers.[24]

E. Application of the Disclosure Obligation to Bank Dealers

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

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20 17 CFR 240.15l-1(a)(2)(i).

21 17 CFR 240.15l-1(a)(2)(ii).

22 17 CFR 240.15l-1(a)(2)(iii).

23 17 CFR 240.15l-1(a)(2)(iv).

24 Notice, 87 FR at 28085.

involving securities that may be recommended to the retail customer;[25] and (b) all material facts relating to conflicts of interest that are associated with the retail municipal recommendation.[26]

F. Application of the Care Obligation to Bank Dealers

Consistent with Regulation Best Interest's Care Obligation, the proposed Best Interest Amendments would require a Bank Dealer to exercise reasonable diligence, care, and skill to: (a) understand the potential risks, rewards, and costs associated with any retail municipal recommendation, and have a reasonable basis to believe that a retail municipal recommendation could be in the best interest of at least some retail customers; (b) have a reasonable basis to believe that the retail municipal recommendation is in the best interest of a particular retail customer, based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation, and does not place the financial or other interest of the Bank Dealer ahead of the interest of the retail customer; (c) have a reasonable basis to believe that a series of retail municipal recommendations, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile and does not place the financial or other interest of the Bank Dealer ahead of the interest of the retail customer.[27]

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

Consistent with Regulation Best Interest's Conflict-of-Interest Obligation, the proposed Best Interest Amendments would require a Bank Dealer to establish, maintain, and enforce

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[25] The MSRB offered the example that, if the applicable legal charter of a Bank Dealer only permits a Bank Dealer to conduct municipal securities activities or, in fact, a Bank Dealer's business model is limited to municipal securities activities, then the Bank Dealer generally would be required to accurately disclose the fact that it only engages in transactions involving municipal securities and, therefore, will only make recommendations to a retail customer regarding transactions involving municipal securities. Notice, 87 FR at 28085, n. 18.

[26] Notice, 87 FR at 28085.

[27] Notice, 87 FR at 28086.

written policies and procedures reasonably designed to: (a) identify and at a minimum disclose, in accordance with its Disclosure Obligation, or eliminate, all conflicts of interest associated with such retail municipal recommendations; (b) identify and mitigate any conflicts of interest associated with such retail municipal recommendations that create an incentive for a natural person who is an associated person of the Bank Dealer to place the interests of the Bank Dealer or such associated person ahead of the interest of the retail customer; (c)(i) identify and disclose any material limitations placed on the securities or investment strategies involving securities that may be recommended to a retail customer and any conflicts of interest associated with such limitations, in accordance with its Disclosure Obligation, and (ii) prevent such limitations and associated conflicts of interest from causing the Bank Dealer to make retail municipal recommendations that place the interest of the Bank Dealer ahead of the interest of the retail customer; and (d) identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific municipal securities or specific types of municipal securities within a limited period of time.[28]

H. Application of the Compliance Obligation to Bank Dealers

Consistent with Regulation Best Interest's Compliance Obligation, the proposed Best Interest Amendments would require a Bank Dealer to establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest.[29]

I. Purpose and Intent of the Best Interest Amendments

The MSRB stated that it proposed the Best Interest Amendments to MSRB Rule G-19 for purposes of enhancing the standard of investor protection in the municipal securities market and enhancing fairness and efficiency in the municipal securities market by promoting regulatory

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[28] Id.

[29] Id.

parity among Bank Dealers and Broker-Dealers.[30] Specific to enhancing the standard of investor protection, the MSRB noted that it believes that all retail customers receiving a retail municipal recommendation should benefit from the enhanced investor protections afforded by Regulation Best Interest, regardless of whether such a retail customer is a customer of a Broker-Dealer or a Bank Dealer.[31] Currently, retail customers of Bank Dealers are not afforded the protections of Regulation Best Interest when receiving a retail municipal recommendation from a Bank Dealer.[32] The MSRB also stated that, as the proposed Best Interest Amendments would require a Bank Dealer to comply with the enhanced standard of conduct required by Regulation Best Interest, the MSRB believes that the Best Interest Amendments would improve overall investor protection in the municipal securities market.[33]

Specific to promoting regulatory parity, the MSRB stated that it believed that the proposed Best Interest Amendments would establish a uniform regulatory standard in the municipal securities market by requiring the same standard of conduct for Bank Dealers and Broker-Dealers when making retail municipal recommendations.[34] The MSRB noted that this uniform standard would enhance the fairness and efficiency of the municipal securities market by ensuring Bank Dealers have regulatory obligations and burdens when engaging in retail municipal recommendations that are equivalent to the regulatory obligations and burdens of Broker-Dealers when engaging in the same municipal securities activities.[35] The MSRB stated that this uniformity would better ensure that Bank Dealers do not have a competitive advantage

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30 Id.

31 Id.

32 Id.

33 Id.

34 Id.

35 Id.

in the municipal securities market by operation of a less burdensome regulatory standard of conduct and, thereby, mitigate the potential for regulatory arbitrage.[36]

J. Background and Purpose of the Institutional SMMP Amendment

The MSRB stated that the proposed Institutional SMMP Amendment would amend MSRB Rule G-48 to modify the current obligation to perform a quantitative suitability analysis for recommendations where the dealer does not have actual control or de facto control over the account of an SMMP who is not a retail customer[37] under Regulation Best Interest (collectively, "Institutional SMMPs" and, individually, each an "Institutional SMMP").[38]

As is the case with the reduced customer-specific suitability obligations currently afforded to Institutional SMMPs under MSRB Rule G-48(c), the MSRB stated that it believes that dealers transacting with Institutional SMMPs should have similarly reduced quantitative-suitability obligations in instances where the dealer does not have actual control or de facto control over the account of an Institutional SMMP.[39] The MSRB noted that this modification would effectively revert the quantitative suitability standard for Institutional SMMPs back to the previously existing standard that was in place under MSRB rules prior to June 30, 2020.[40] The

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36 Id.

37 See supra note 11 for the applicable definition of "retail customer" and related citation. Any customer meeting such definition of retail customer pursuant to Regulation Best Interest would not be considered an Institutional SMMP for the purposes of the proposed Institutional SMMP Amendment and its modification to MSRB Rule G-48. For purposes of MSRB rules, such a customer meeting the definition of a "retail customer" would receive the protections afforded by Regulation Best Interest.

38 Notice, 87 FR at 28086.

39 Id.

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

MSRB stated that the proposed Institutional SMMP Amendment is intended to improve the efficiency of the municipal securities market without eroding investor protection by aligning the compliance burden associated with certain recommendations made by dealers to the reasonable expectations and capabilities of Institutional SMMPs – who by their nature are more sophisticated, non-natural-person customers and must affirmatively indicate their capacity to (i) exercise independent judgment and (ii) access material information.[41]

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

MSRB Rule G-19 sets the MSRB's baseline investor protection standards regarding the suitability of recommendations made by dealers to their customers of purchases, sales, or exchanges of municipal securities that are not subject to Regulation Best Interest.[42] Among other requirements, Supplementary Material .05 of MSRB Rule G-19 enumerates three components of a dealer's suitability analysis when recommending a transaction or investment strategy involving a municipal security or municipal securities to a non-retail customer (i.e., a recommendation that is not subject to Regulation Best Interest).[43] As further defined in the text of the rule, MSRB Rule G-19 provides that a dealer's suitability obligation is composed of (i) reasonable-basis suitability, (ii) customer-specific suitability, and (iii) quantitative suitability.[44] Most relevant to the proposed Institutional SMMP Amendment of this proposed rule change, quantitative suitability requires a dealer to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and

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

41 Notice, 87 FR at 28086-87. See also MSRB Rule G-48(c).

42 MSRB Rule G-19.

43 See the Broker-Dealer Harmonization Filing, 85 FR at 28084. The Broker-Dealer Harmonization Filing amended MSRB Rule G-19 to provide that the rule does not apply to recommendations subject to Regulation Best Interest. Notice, 87 FR at 28087, n. 23.

44 Notice, 87 FR at 28087.

unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in MSRB Rule G-19.[45] No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a dealer has violated the quantitative suitability obligation.[46]

Pursuant to the amendments effectuated by the Broker-Dealer Harmonization Filing, discussed above and effective as of June 30, 2020, the quantitative suitability obligation of MSRB Rule G-19 no longer incorporates an element of control in relation to a customer's account.[47] As a result, dealers are currently obligated to conduct a quantitative suitability analysis under MSRB Rule G-19 when making recommendations to Institutional SMMPs, even in instances where the dealer does not have actual control or de facto control over the account.[48] The obligation applies notwithstanding the fact that Institutional SMMPs self-identify under MSRB Rule G-48 and MSRB Rule D-15 as having the willingness and requisite investment

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

46 Id.

47 Stated differently, as of June 30, 2020, if the obligations of MSRB Rule G-19 attach to a dealer's recommendation, then the investor protections regarding quantitative suitability apply regardless of whether the dealer making the recommendation exercises any actual control or de facto control over the customer's account. Notice, 87 FR at 28087, n. 26. The Broker-Dealer Harmonization Filing amended this language of Supplementary Material .05(c) to eliminate such control requirements, effectively extending the requirements of quantitative suitability to any customer account. See Broker-Dealer Harmonization Filing, 85 FR at 28084. June 30, 2020 was the compliance date for the amendments enacted by the Broker-Dealer Harmonization Filing. See Broker-Dealer Harmonization Filing, 85 FR at 28082, n. 4. Pursuant to the Broker-Dealer Harmonization Filing, the MSRB also notes that this quantitative suitability obligation applies uniformly to any dealer (i.e., the same regulatory obligations apply to both Broker-Dealers and Bank Dealers). Notice, 87 FR at 28087, n. 26.

48 Notice, 87 FR at 28087.

sophistication to, for example, independently evaluate the recommendations of a dealer and the quality of a dealer's execution, as further discussed below.[49]

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

MSRB Rule G-48 provides for modified dealer regulatory obligations under MSRB rules when dealing with certain customers that meet the definition of a Sophisticated Municipal Market Participant (i.e., an SMMP).[50] More specifically, when transacting with an SMMP customer, Rule G-48 modifies aspects of a dealer's baseline regulatory obligations in terms of: (i) time of trade disclosures,[51] (ii) transaction pricing,[52] (iii) bona fide quotations,[53] (iv) best execution,[54] and (vi) suitability.[55] The modified regulatory obligations afforded to SMMPs under MSRB rules are intended to account for the distinct capabilities of certain sophisticated,

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

50 MSRB Rule G-48.

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

52 MSRB Rule G-48(b).

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

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

55 MSRB Rule G-48(c).

non-retail customers and the varied types of dealer-customer relationships occurring in the municipal securities market.[56]

Most relevant to the proposed Institutional SMMP Amendment, Rule G-48(c) currently modifies the suitability requirements of MSRB Rule G-19 by eliminating the requirement for dealers to conduct a customer-specific suitability analysis for recommendations made to an Institutional SMMP.[57] The operative provision of MSRB Rule G-48 provides that, "[w]hen making a recommendation subject to Rule G-19 and not Regulation Best Interest, Rule 15l-1 under the Act, a broker, dealer, or municipal securities dealer shall not have any obligation under Rule G-19 to perform a customer-specific suitability analysis."[58] This relaxed customer-specific suitability obligation is generally aligned with the "independent judgment" affirmations a customer seeking SMMP status makes under MSRB Rule D-15. The proposed Institutional SMMP Amendment would likewise relax the quantitative suitability obligation for similar reasons, as further described in the following sections.[59]

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

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

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

58 MSRB Rule G-48(c).

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

MSRB Rule G-48 incorporates the definition of SMMP under MSRB Rule D-15 for purposes of defining which customers do (or do not) qualify as an SMMP for purposes of Rule G-48 and, therefore, MSRB Rule D-15 establishes the scope of potential customers who might qualify for MSRB Rule G-48's modified obligations.[60] The SMMP definition in MSRB Rule D-15 enumerates three components, which separately address: (i) the minimum qualifying traits and characteristics of an SMMP customer; [61] (ii) that a dealer must develop a reasonable basis for determining whether a customer has the requisite level of expertise and sophistication to be deemed an SMMP customer (the "SMMP Reasonable Basis Determination");[62] and (iii) the affirmations that a customer must communicate to the dealer regarding its own investment judgment and access to information in order to be appropriately deemed an SMMP customer (the "SMMP Customer Affirmations").[63]

With respect to the SMMP Customer Affirmations, MSRB Rule D-15(c) provides that the customer must affirmatively indicate to the dealer that (i) it is exercising independent judgment in evaluating the recommendations of the dealer; the quality of execution of the customer's transactions by the dealer; and the transaction price for non-recommended secondary market agency transactions as to which the dealer's services have been explicitly limited to providing anonymity, communication, order matching and/or clearance functions and the dealer

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60 MSRB Rule G-48.

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

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

63 MSRB Rule D-15(c).

does not exercise discretion as to how or when the transactions are executed;[64] and (ii) it has timely access to material information that is available publicly through established industry sources as defined in MSRB Rule G-47(b)(i) and MSRB Rule G-47(b)(ii) (i.e., "material information" from "established industry sources," such as EMMA website information and rating agency reports).[65]

The MSRB noted that an institutional customer who self-identifies as an SMMP has freely affirmed to a dealer its willingness to be treated as a sophisticated customer with the capacity and resources to exercise its own independent judgment.[66] The MSRB stated that, in this way, the SMMP Customer Affirmations are designed to ensure that any customer treated as an SMMP has affirmatively and knowingly provided the grounds on which a dealer may afford such SMMP customer lesser protections under certain MSRB rules.[67] As an additional investor protection safeguard beyond the requirement for SMMP Customer Affirmations, the SMMP Reasonable Basis Determination also requires a dealer to have a reasonable basis to believe that an SMMP customer is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions and investment strategies in municipal securities.[68] The MSRB noted that, in this way, the SMMP Reasonable Basis Determination further ensures that an Institutional SMMP does in fact possess a more sophisticated

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

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

66 Notice, 87 FR at 28088.

67 Id.

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

understanding of the municipal securities market.[69] The MSRB noted that the proposed Institutional SMMP Amendment would not alter the SMMP Customer Affirmations, the SMMP Reasonable Basis Determination, nor any of the other definitional elements of MSRB Rule D-15 that must be satisfied for a customer to qualify as an SMMP.[70]

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

The MSRB stated that the proposed Institutional SMMP Amendment would amend MSRB Rule G-48 to modify the quantitative suitability obligations of dealers when effecting transactions for their Institutional SMMPs.[71] The proposed Institutional SMMP Amendment would require a dealer to conduct a quantitative suitability analysis only in situations where the dealer has actual control or de facto control over an Institutional SMMP's account.[72] As stated above, the proposed amendments to MSRB Rule G-48 would narrowly reinstate the scope of suitability protections afforded to Institutional SMMPs in effect prior to the amendments effectuated by the Broker-Dealer Harmonization Filing, and so should be a familiar regulatory concept to dealers and Institutional SMMPs alike.[73]

More importantly, because each Institutional SMMP must self-identify as an SMMP by making the SMMP Customer Affirmations, as well as fulfill the requirements associated with a dealer's SMMP Reasonable Basis Determination, the MSRB stated that the proposed

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69 Notice, 87 FR at 28088

70 Id.

71 Id.

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

73 Notice, 87 FR at 28088.

Institutional SMMP Amendment would ease a regulatory burden on dealers that effectively replicates the sort of analysis an Institutional SMMP is willing and capable of performing itself.[74] As a result, the MSRB noted that the proposed Institutional SMMP Amendment would align the compliance burden associated with certain recommendations made by dealers to the reasonable expectations and capabilities of Institutional SMMPs.[75]

Although the MSRB noted that investor protection benefits associated with requiring dealers to perform a potentially duplicative suitability analysis can be appropriate in other circumstances,[76] the MSRB stated that the compliance burden associated with performing a quantitative suitability analysis on recommendations made to Institutional SMMPs outweighs the potential marginal investor protection benefits.[77] The MSRB noted that the proposed Institutional SMMP Amendment would promote efficiency in the municipal securities market by eliminating a regulatory burden on dealers that potentially provides a duplicative or unneeded analyses in supplement of an Institutional SMMPs' own independent and informed judgment.[78] The MSRB stated that the proposed Institutional SMMP Amendment would allow dealers to redirect the resources associated with this regulatory burden to other more productive market activities.[79]

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74 Id.

75 Id.

76 Notice, 87 FR at 28088-89. For example, the MSRB believes that the obligation to perform quantitative suitability analyses under MSRB rules remains appropriate, regardless of the potential for such duplication, in circumstances of recommendations made to retail customers; non-retail, institutional customers who fail to meet the characteristics of an SMMP; and/or non-retail customers who have declined to make the affirmations necessary to be appropriately deemed an SMMP. Notice, 87 FR at 28089, n. 46.

77 Notice, 87 FR at 28089.

78 Id.

79 Id.

III. Discussion and Commission Findings

The Commission has carefully considered the proposed rule change. The Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the MSRB.

In particular, the Commission believes that the proposed rule change is consistent with the provisions of Exchange Act Section 15B(b)(2)(C), which provides, in part, that the MSRB's rules shall be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities and municipal financial products, and 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.[80]

A. Commission Findings for the Best Interest Amendments

The Commission finds that the proposed Best Interest Amendments are consistent with Section 15B(b)(2)(C) of the Act[81] because the amendments would: (i) prevent fraudulent and manipulative acts and practices; (ii) promote just and equitable principles of trade; (iii) 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; (iv) remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products; and (v) protect investors, municipal entities, obligated persons, and the public interest.

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80 15 U.S.C. 78o-4(b)(2)(C).

81 Id.

i. Prevent Fraudulent And Manipulative Acts And Practices

The Commission finds that the proposed Best Interest Amendments would prevent fraudulent and manipulative acts and practices by extending the enhanced standards of conduct required by Regulation Best Interest to the retail municipal recommendations of Bank Dealers. As noted by the Commission in the adopting release for Regulation Best Interest, Regulation Best Interest enhances the broker-dealer standard of conduct beyond existing suitability obligations.[82] Specifically, the proposed Best Interest Amendments would mandate Bank Dealers act in the best interest of the retail customer at the time the recommendation is made (without placing the financial or other interest of the Broker-Dealer ahead of the interest of the retail customer).[83] As such, the Commission finds that the proposed Best Interest Amendments would enhance the quality of Bank Dealer retail municipal recommendations.

The Commission further finds that the proposed Best Interest Amendments would address conflicts of interest in connection with Bank Dealer retail municipal recommendations, by establishing, maintaining, and enforcing policies and procedures reasonably designed to identify and fully and fairly disclose material facts about conflicts of interest (and in instances where it is determined that disclosure is insufficient to reasonably address the conflict, to mitigate, or in certain instances, eliminate the conflict).[84] Therefore, the Commission finds that reducing the potential harm to retail customers that may be caused by conflict of interest in connection with Bank Dealer retail municipal recommendations.

By enhancing the quality of Bank Dealer recommendations to retail customers and mitigating harm to retail customers from potential conflict of interest, the Commission believes that the proposed Best Interest Amendments would prevent potential fraudulent and

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

83 Notice, 87 FR at 28085.

84 Notice, 87 FR at 28086.

manipulative acts and practices and promote the protection of the retail customers of Bank Dealers.[85]

ii. Promote Just And Equitable Principles Of Trade

The Commission finds that the proposed Best Interest Amendments' mandate of a uniform standard among Broker-Dealers and Bank Dealers when making recommendations to retail customers in municipal securities would promote just and equitable principles of trade within the municipal securities market. Specifically, the proposed Best Interest Amendments would ensure Bank Dealers have regulatory obligations and burdens when engaging in retail municipal recommendations that are generally equivalent to the regulatory obligations and burdens of Broker-Dealers (when engaging in the same municipal securities activities).[86] The Commission notes that this uniformity would better ensure that Bank Dealers do not have a competitive advantage in the municipal securities market by operation of a less burdensome regulatory standard of conduct. Therefore, the Commission finds that the proposed Best Interest Amendments will mitigate the potential for regulatory arbitrage and thereby promote just and equitable principles of trade.

iii. 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

The Commission finds that the proposed Best Interest Amendments would foster cooperation and coordination between the MSRB, SEC, and other regulators by aligning the suitability obligations of MSRB Rule G-19 with the suitability obligations of Regulation Best Interest.[87] The Commission notes that such alignment would establish a uniform standard of suitability obligations among Broker-Dealers and Bank Dealers when making retail municipal

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

86 Notice, 87 FR at 28086.

87 Notice, 87 FR at 28085.

recommendations, creating regulatory clarity regarding retail municipal recommendations. As such, the Commission finds that the proposed Best Interest Amendments will foster greater cooperation and coordination among the authorities that examine Broker-Dealers and Bank Dealers for compliance with MSRB rules, as well as authorities that enforce those rules.

iv. Remove Impediments To And Perfect The Mechanism Of A Free And Open Market In Municipal Securities And Municipal Financial Products

The Commission finds that the proposed Best Interest Amendments would remove impediments to, and perfect the mechanism of, a free and open market in municipal securities by creating a uniform regulatory standard for retail municipal recommendations. By establishing one standard for retail municipal recommendations, the Commission finds that the proposed Best Interest Amendments would eliminate confusion about duties Bank Dealers (with retail customers and non-retail customers) owe to retail customers regarding municipal securities recommendations.[88] The Commission further notes that having one standard of retail municipal recommendations would also eliminate confusion about the duties retail customers (who have accounts with both Bank Dealers and Broker-Dealers) can expect from Bank Dealers and Broker-Dealers regarding municipal securities recommendations. The Commission finds that the Best Interest Amendments would reduce Bank Dealers' and retail customers' confusion regarding the duties associated with providing retail municipal recommendation. As such, the Commission holds that the proposed Best Interest Amendments remove impediments to the municipal security market, removing uncertainty surrounding retail municipal recommendations.

v. Protect Investors, Municipal Entities, Obligated Persons, And The Public Interest

The Commission believes that the proposed Best Interest Amendments' revision to MSRB Rule G-19 will protect investors by ensuring Bank Dealers comply with the heightened regulatory requirements of the Commission's Regulation Best Interest rather than current MSRB

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[88] Id.

G-19.[89] By uniformly applying the investor protections provided by Regulation Best Interest, the proposed Best Interest Amendments would ensure that a retail customer will receive the enhanced investor protections of Regulation Best Interest, regardless of whether a Broker-Dealer or a Bank Dealer makes retail municipal recommendation. In doing so, the Commission finds that the proposed Best Interest Amendments thereby protect investors, municipal entities, obligated persons, and the public interest.

B. Commission Findings for the Institutional SMMP Amendment

The Commission finds that the proposed Institutional SMMP Amendment is consistent with Section 15B(b)(2)(C)[90] of the Act in that such amendment would remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, without materially diminishing the prevention of fraudulent and manipulative acts and practices; or the protect investors, municipal entities, obligated persons, and the public interest.

Specifically, the Commissions finds that the proposed Institutional SMMP Amendment would remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial product by eliminating the current requirement to perform a quantitative suitability analysis for recommendations in circumstances where the dealer does not have actual control or de facto control over an Institutional SMMP's account.[91] The Commission notes that ending this requirement could eliminate potentially duplicative analyses undertaken by dealers on behalf of Institutional SMMPs. In particular, the Commission notes that Institutional SMMPs have already affirmed their capacity and expertise to conduct such analyses for themselves, and presumably, the Institutional SMMPs presumably have taken upon themselves to perform such analyses.

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89 Id.

90 15 U.S.C. 78o-4(b)(2)(C).

91 Notice, 87 FR at 28088.

Therefore, the Commission believes that the proposed Institutional SMMP Amendment would facilitate transactions in municipal securities and remove impediments to and perfect the mechanism of a free and open market in municipal securities by reducing a compliance burden.

The Commission further believes that proposed Institutional SMMP Amendment would not materially diminish the prevention of fraudulent and manipulative acts and practices under MSRB Rule G-19, as amended by the proposed Best Interest Amendments, by incorporating the concepts of actual control or de facto control.[92] Specifically, the Commission believes that reinstating control elements would help address potential scenarios in which the ability of an Institutional SMMP to exercise independent judgment is undermined or circumvented. Such a situation may occur when a dealer may not have formal discretionary authority over an Institutional SMMP's account, but nevertheless exercises de facto control over the account (to, for example, engage in churning activity in clear contravention of an Institutional SMMP's investment interests). The Commission further finds that the proposed Institutional SMMP Amendment's incorporating the actual control or de facto control elements maintains baseline investor protections for Institutional SMMPs in such scenarios of greater dealer impropriety or intentional wrongdoing.

Similarly, the Commission believes that the proposed Institutional SMMP Amendment will not materially diminish the protection of investors, municipal entities, and obligated person, and the public interest provided by MSRB Rule G-19, as amended by the proposed Best Interest Amendments. Specifically, under the proposed Institutional SMMP Amendment, new institutional customers, who otherwise would qualify as SMMPs but desire the additional investor protections afforded by quantitative suitability under MSRB Rule G-19, may decline to provide the required affirmations under MSRB Rule D-15.[93] The Commission notes that, under

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92 Notice, 87 FR at 28088.

93 Notice, 87 FR at 28090.

the proposed rule change, existing Institutional SMMPs could withdraw their SMMP status and obtain the suitability protections afforded by MSRB Rule G-19. The Commission believes this ability to self-identify as an Institutional SMMP will help ensure that those institutional customers who desire additional investor protection can secure them under MSRB rules, which would then require a dealer to undertake a quantitative suitability analysis. Accordingly, the Commission finds that the proposed Institutional SMMP Amendment would not materially diminish essential safeguards for investor protection.

In approving the proposed rule change, the Commission has considered the proposed rule change's impact on efficiency, competition, and capital formation.[94] Exchange Act Section 15B(b)(2)(C)[95] requires that MSRB rules not be designed to impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The Commission does not believe that the proposed Best Interest Amendments would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act because the proposed rule change would align MSRB rules with the requirements of Regulation Best Interest. As such, the proposed Best Interest Amendments will reduce the potential for regulatory arbitrage and any attendant disruption it could have caused in the competitive landscape between Broker-Dealers and Bank Dealers regarding retail municipal recommendations. Consequently, the proposed Best Interest Amendments will not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, because it establishes a uniform regulatory environment for all retail municipal recommendations.

The Commission further believes that the proposed Institutional SMMP Amendment would not impose any burden on competition not necessary or appropriate in furtherance of the

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94 15 U.S.C. 78c(f).

95 15 U.S.C. 78o-4(b)(2)(C).

purposes of the Exchange Act because the proposed rule change would be equally applicable to all dealers. As such, the Commission finds that any benefits or burdens to competition would be evenly applied to all such firms transacting with institutional customers. Therefore, neither the proposed Best Interest Amendments nor the proposed Institutional SMMP Amendment do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The Commission has also reviewed the record for the proposed rule change and notes that the record does not contain any information to indicate that the proposed rule change would have a negative effect on capital formation. Further, the Commission finds that the possible increased investor protection offered by the proposed Best Interest Amendments and the possible operational efficiency proposed Institutional SMMP Amendments could foster greater faith in the integrity of the municipal security market, increasing participation in this market, thereby increase capital formation.

The Commission also finds that the proposed rule change includes provisions that help promote efficiency. In particular, the Commission believes the proposed Best Interest Amendments may improve Broker Dealers and Bank Dealers' effectiveness in providing retail municipal recommendations by promoting a uniform standard of suitability requirements (for example, increasing compliance efficiency for firms who have both Broker-Dealer and Bank Dealer subsidiaries). The Commission also notes that the proposed Institutional SMMP Amendment may improve the operational efficiency of the municipal securities market. By reintroducing the element of actual control or de facto control with respect to Institutional SMMP accounts that would trigger a dealer's quantitative suitability obligation, the Commission finds that the proposed Institutional SMMP Amendment could eliminate potentially duplicative analyses undertaken by dealers on behalf of Institutional SMMPs.

The Commission received no comment letters on the proposed rule change.

For the reasons noted above, the Commission believes that the proposed rule change is

consistent with the Exchange Act.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,[96] that the proposed rule change (SR-MSRB-2022-02) be, and hereby is, approved.

For the Commission, pursuant to delegated authority.[97]

J. Matthew DeLesDernier,

Assistant Secretary.

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96 15 U.S.C. 78s(b)(2).

97 17 CFR 200.30-3(a)(12).