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**Category**

Fair Practice

**Affected Rules**

[Rule G-19](#), [Rule G-48](#)

## MSRB Applies Regulation Best Interest to Bank-Dealers and Amends the Quantitative Suitability Standard for Institutional SMMPs

### Overview

The Municipal Securities Rulemaking Board (MSRB) received approval<sup>1</sup> from the U.S. Securities and Exchange Commission (SEC or “Commission”) on June 23, 2022, for amendments to [MSRB Rule G-19](#), on suitability of recommendations and transactions, and [MSRB Rule G-48](#), on transactions with sophisticated municipal market professionals (“SMMPs”).<sup>2</sup>

The amendments approved by the Commission align Rule G-19 to the Commission’s Rule 15l-1 under the Exchange Act (“Regulation Best Interest”)<sup>3</sup> for certain municipal securities activities of bank dealers (the “Bank Dealer Amendment”).<sup>4</sup> The approved amendments to Rule G-48 modify the quantitative suitability obligation of brokers, dealers, and

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<sup>1</sup> Exchange Act Release No. 95145 (June 23, 2022) (File No. SR-MSRB-2022-02).

<sup>2</sup> 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].”

<sup>3</sup> 17 CFR § 240.15l-1.

<sup>4</sup> Consistent with MSRB Rule D-8, the term “bank dealer” 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.” This notice collectively refers to such entities as “Bank Dealers.”

municipal securities dealers (collectively, “dealers”) for certain institutional SMMP customers (the “Quantitative Suitability Amendment”).<sup>5</sup>

## Compliance Dates

The compliance date for the Quantitative Suitability Amendment is August 1, 2022. The compliance date for the Bank Dealer Amendment is August 1, 2023.

## Summary of the Amendments

### A. Background and Summary of the Bank Dealer Amendment

The Bank Dealer Amendment will require a Bank Dealer to comply with the Commission’s Regulation Best Interest to the same extent as if it were a broker-dealer when making recommendations to retail customers of municipal securities transactions or investment strategies involving municipal securities.<sup>6</sup>

#### 1. 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

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<sup>5</sup> As further described in this notice and the related filings, the Quantitative Suitability Amendment only affects accounts for customers who meet the definition of an SMMP under MSRB Rule D-15 and who do not meet the definition of a retail customer under the Commission’s Regulation Best Interest. This notice collectively refers to such customers as “Institutional SMMPs.” See the following footnote for the applicable definition of a retail customer under Regulation Best Interest and the related discussion. Relatedly, 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 Quantitative Suitability Amendment and its modification to MSRB Rule G-48. For purposes of MSRB rules as modified by the Quantitative Suitability Amendment and Bank Dealer Amendment, such a customer meeting the definition of a “retail customer” would receive the protections afforded by the Commission’s Regulation Best Interest.

<sup>6</sup> Consistent with the definition in Regulation Best Interest, the term “retail customer” as used in this notice means “a natural person, or the legal representative of such natural person, who: (i) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and (ii) Uses the recommendation primarily for personal, family, or household purposes.” See Rule 15c-1(b)(1).

securities transaction or investment strategy involving securities.<sup>7</sup> 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.<sup>8</sup> The Commission’s adoption of Regulation Best Interest enhanced the Broker-Dealer standard of conduct beyond existing suitability obligations, such as those required by Rule G-19, for such retail customers and aligned the applicable standard of conduct with the reasonable expectations of retail customers.<sup>9</sup> In this regard, Regulation Best Interest imposes the following “general obligation”:

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.<sup>10</sup>

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<sup>7</sup> See, generally, 17 CFR § 240.15/-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”). In response, on May 1, 2020, the MSRB filed a proposed rule change with the Commission to harmonize Regulation Best Interest with certain MSRB rules applicable to related municipal securities activities of Broker-Dealers. See also [Exchange Act Release No. 88828 \(May 6, 2020\), 85 FR 28082, File No. SR-MSRB-2020-02](#) (hereinafter, the “Broker-Dealer Harmonization Filing”). The Commission approved these proposed amendments on June 25, 2020. See [Exchange Act Release No. 89154 \(June 25, 2020\), 85 FR 39613 \(July 1, 2020\), File No. SR-MSRB-2020-02](#).

<sup>8</sup> 17 CFR § 240.15/-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](#).

<sup>9</sup> Regulation Best Interest Adopting Release, 84 FR at 33319.

<sup>10</sup> 17 CFR § 240.15/-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-

The Commission's 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"); (ii) an obligation to exercise reasonable diligence, care, and skill in making a recommendation (the "Care Obligation"); (iii) an obligation to establish, maintain, and enforce written policies and procedures reasonable designed to address conflicts of interest (the "Conflict of Interest Obligation"); and (iv) an obligation to establish, maintain, and enforce written policies and procedures reasonable designed to achieve compliance with Regulation Best Interest (the "Compliance Obligation").

## 2. Bank Dealer Amendment as Approved

As approved, the Bank Dealer Amendment to Rule G-19 requires a Bank Dealer to comply with Regulation Best Interest to the same extent as if it were a Broker-Dealer when making recommendations to retail customers of municipal securities transactions or investment strategies involving municipal securities (collectively, "retail municipal recommendations" and individual, each a "retail municipal recommendation"). Consequently, a Bank Dealer will have to act in the best interest of the retail customer at the time a retail municipal recommendation is made, without placing the financial or other interests of the Bank Dealer ahead of the interest of the retail customer. Correspondingly, Bank Dealers will have to comply with the Commission's component obligations of Regulation Best Interest to the same extent as if it were a Broker-Dealer in relation to such retail municipal recommendations, including Regulation Best Interest's

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Dealer (the "Disclosure Obligation") (See 17 CFR § 240.15f-1(a)(2)(i)); (ii) an obligation to exercise reasonable diligence, care, and skill in making a recommendation (the "Care Obligation") (See 17 CFR § 240.15f-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 § 240.15f-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 § 240.15f-1(a)(2)(iv)).

Disclosure Obligation,<sup>11</sup> Care Obligation,<sup>12</sup> Conflict-of-Interest Obligation,<sup>13</sup> and Compliance Obligation.<sup>14</sup>

## B. Background and Summary of the Quantitative Suitability Amendment

The Quantitative Suitability Amendment will require a dealer to conduct a quantitative suitability analysis only in situations where a dealer has actual control or de facto control over an Institutional SMMP's account.

### 1. Background on Rule G-48, SMMPs, and Quantitative Suitability

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). 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,<sup>15</sup> (ii) transaction pricing,<sup>16</sup> (iii) bona fide quotations,<sup>17</sup> (iv) best execution,<sup>18</sup> and (v) suitability.<sup>19</sup> The modified regulatory obligations afforded to SMMPs under these MSRB rules are intended to account for the distinct

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<sup>11</sup> 17 CFR § 240.15/-1(a)(2)(i).

<sup>12</sup> 17 CFR § 240.15/-1(a)(2)(ii).

<sup>13</sup> 17 CFR § 240.15/-1(a)(2)(iii).

<sup>14</sup> 17 CFR § 240.15/-1(a)(2)(iv).

<sup>15</sup> 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.")

<sup>16</sup> Rule G-48(b).

<sup>17</sup> 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.")

<sup>18</sup> 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.")

<sup>19</sup> Rule G-48(c).

capabilities of certain sophisticated, non-retail customers<sup>20</sup> and the varied types of dealer-customer relationships occurring in the municipal securities market.<sup>21</sup>

Rule G-19 generally sets the MSRB's baseline investor protection standards regarding the suitability of recommendations made by dealers to their customers of purchases, sales, or exchanges of municipal securities that are not subject to Regulation Best Interest. Among other requirements, Supplementary Material .05 of 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).<sup>22</sup> As further defined in the text of the rule, Rule G-19 provides that a dealer's suitability obligation is composed of (i) reasonable-basis suitability, (ii) customer-specific suitability, and (iii) quantitative suitability. Most relevant to the approved amendments:

"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 unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in [MSRB] Rule G-19. No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a [dealer] has violated the quantitative suitability obligation."<sup>23</sup>

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<sup>20</sup> See, *e.g.*, MSRB Rule D-15(c) (requiring Institutional SMMPs to "affirmatively indicate," among other things, that it is exercising independent judgment in evaluating (A) the recommendations of the dealer and (B) the quality of execution of the customer's transactions by the dealer).

<sup>21</sup> 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).

<sup>22</sup> See the Broker-Dealer Harmonization Filing, 85 FR at 28084. The Broker-Dealer Harmonization Filing amended Rule G-19 to provide that the rule does not apply to recommendations subject to Regulation Best Interest.

<sup>23</sup> Rule G-19, Supplementary Material .05(c).

Effective as of June 30, 2020, the quantitative suitability obligation of Rule G-19 no longer incorporated an element of control in relation to a customer's account.<sup>24</sup> As a result, dealers have been obligated to conduct a quantitative suitability analysis under 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.

## 2. Quantitative Suitability Amendment as Approved

Similar to the reduced customer-specific suitability obligations currently afforded to Institutional SMMPs under Rule G-48(c), the Quantitative Suitability Amendment to Rule G-48 reduces the quantitative-suitability obligations that dealers transacting with Institutional SMMPs have in instances where the dealer does not have actual control or de facto control over the account of an Institutional SMMP. This modification effectively reverts the quantitative suitability standard for Institutional SMMPs back to the standard that was in place under MSRB rules prior to June 30, 2020.<sup>25</sup>

More specifically, the Quantitative Suitability Amendment eliminates 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 Institutional SMMP. Therefore, pursuant to the Quantitative Suitability Amendment, a

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<sup>24</sup> In other words, as of June 30, 2020, if the obligations of Rule G-19 attach to a dealer's recommendation, then the investor protections regarding quantitative suitability apply regardless of whether the dealer making the recommendation exercises any actual control or de facto control over the customer's account. The Broker-Dealer Harmonization Filing amended this language of Supplementary Material .05(c) to eliminate such control requirements, effectively extending the requirements of quantitative suitability to any customer account. See Broker-Dealer Harmonization Filing, 85 FR at 28084. June 30, 2020 was the compliance date for the amendments enacted by the Broker-Dealer Harmonization Filing. See Broker-Dealer Harmonization Filing, 85 FR at 28082, n. 4. Pursuant to the Broker-Dealer Harmonization Filing, the MSRB also notes that this quantitative suitability obligation applies uniformly to any dealer (*i.e.*, the same regulatory obligations apply to both Broker-Dealers and Bank Dealers).

<sup>25</sup> See Broker-Dealer Harmonization Filing, 85 FR at 28082, n. 4. The MSRB notes that it has had a long held prohibition against "churning," and the MSRB formally "recast" this prohibition as quantitative suitability through an amendment to Rule G-19 approved by the SEC in 2014. See [Exchange Act Release No. 71665 \(Mar. 7, 2014\)](#), [79 FR 2432 \(Mar. 13, 2014\)](#), [File No. SR-MSRB-2013-07](#) (discussing the then-existing MSRB prohibition on churning and a proposed rule change to recast this prohibition using the phrase "quantitative suitability").

dealer is required 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.<sup>26</sup>

## Contact

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

June 24, 2022

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## Text of Amendments\*

### Rule G-19: Suitability of Recommendations and Transactions

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

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

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<sup>26</sup> 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 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 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 Rule D-15 (discussing trade-by-trade affirmations).

\* Underlining indicates new language.



## Supplementary Material

No change.

### Rule G-48: Transactions with Sophisticated Municipal Market Professionals

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

(a) - (b) No change.

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

(d) – (f) No change.