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Compliance Advisory for Brokers, Dealers and Municipal Securities Dealers

Introduction

The Municipal Securities Rulemaking Board (MSRB) is providing this Compliance Advisory as a compliance resource to assist brokers, dealers or municipal securities dealers (collectively “dealers”) in their continuing compliance efforts. This Compliance Advisory highlights certain MSRB rules and provides considerations a dealer could use in assessing its own policies and procedures for compliance with the applicable rules.¹ This Compliance Advisory is not designed to address all regulatory obligations applicable to dealers pursuant to each MSRB rule or under other securities laws and regulations (“applicable rules”) or identify an exhaustive list of considerations for ensuring compliance with the applicable rules. This resource should be read in conjunction with the relevant rules and related guidance. It does not create new legal or regulatory requirements, or new interpretations of existing requirements, and should not be interpreted as establishing new standards of conduct.

Developing the Compliance Advisory

The MSRB is the principal self-regulatory organization for the municipal securities market. The MSRB does not, however, conduct compliance examinations or carry out the enforcement of its rules. The Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA) and federal bank regulators (collectively, “examining authorities”) have the statutory authority to examine for, and enforce, compliance with MSRB rules. To promote regulatory certainty that MSRB rules will be interpreted in the manner in which intended, the MSRB facilitates a robust

¹ The development of this Compliance Advisory reflects information the MSRB has received in the course of operating its programs and initiatives, together with feedback and inquiries from market participants, including dealers, municipal advisors and other regulators.



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coordination program with the examining authorities.²To that end, the MSRB provides the examining authorities, among other things: training for examination and enforcement staff; guidance on MSRB rules in connection with examinations and enforcement activities; information products that assist the examining authorities in their surveillance, examinations and enforcement matters; market information, analytical and statistical data; reports of potential rule violations; and assistance in identifying compliance risks, emerging trends and other issues with respect to the municipal securities market and MSRB rules.

The information the MSRB learns regarding the examination programs assists the MSRB in evaluating the ongoing effectiveness of its rules. In addition, on at least an annual basis, the MSRB meets with the examining authorities to provide input on potential compliance risks relevant to examining compliance with MSRB rules as part of the examining authorities' respective risk-based examination programs.³

The genesis for the MSRB's annual Compliance Advisories was to similarly inform dealers and municipal advisors of potential compliance risks related to MSRB rules and provide examples of considerations a dealer or municipal advisor could find useful in assessing whether a potential compliance risk might be applicable to its activities.⁴ The considerations presented in each Compliance Advisory are intended as practical examples and not exhaustive factors to consider in assessing compliance controls. As such, the

² The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") provided greater clarity on the MSRB's role in supporting the examining authorities (Pub. L. No. 111-203, 124 Stat. 1376). However, boundaries on the MSRB's regulatory assistance remain. For example, the MSRB is not privy to which regulated entities are selected for examination, does not participate in the on-site examinations and is not consulted on every potential or actual finding of an MSRB rule violation. In addition, the examining authorities have significant prosecutorial discretion in enforcing the federal securities laws, including determining when to commence an investigation, bring an enforcement action, charge a particular rule violation and seek particular remedies.

³ Given that the examining authorities must examine for compliance with a broad scope of business activities extending beyond the municipal securities market, municipal securities market topics may not be specifically included in their published examination priorities. Additionally, in examining for compliance with MSRB rules, the examining authorities are not limited to examining for compliance with the rules that are highlighted in this Compliance Advisory.

⁴ See [Compliance Advisory for Municipal Advisors](#) (June 2017); [Compliance Advisory for Municipal Advisors](#) (May 2016); [Compliance Advisory for Brokers, Dealers and Municipal Securities Dealers](#) (February 2016); and [Compliance Advisory for Brokers, Dealers and Municipal Securities Dealers](#) (September 2017).

considerations may not be the only or preferred means to comply with MSRB rules, and the implementation of any specific practice described in a Compliance Advisory is not necessarily a safe harbor nor does it obviate the obligation of a dealer or municipal advisor to develop and maintain a supervisory process reasonably designed to achieve compliance with applicable rules tailored to the nature and scope of the firm's municipal securities and/or municipal advisory activities, as applicable.

Using this Compliance Advisory

This Compliance Advisory provides a summary of certain MSRB rules and sample considerations to assist dealers, including their supervisory principals, in identifying potential compliance risks.⁵ The Compliance Advisory may also serve as a practical reference tool for a dealer in assessing its compliance controls. Recognizing that one firm's approach to compliance may not necessarily be appropriate or reasonable for another firm, dealers should consider their own business model, practices and activities in utilizing this resource. For example, a dealer that does not engage in underwriting activities would likely not have a supervisory process for compliance with MSRB Rule G-11(f) on Designations and Allocations of Securities in Primary Offering Practices and, therefore, the dealer would likely not find the sample considerations related to compliance with such provision useful.

The content of this advisory is derived from the relevant rulemaking record, MSRB rules and existing interpretive guidance and compliance resources and is designed as a supplemental reference document. Unless the context indicates otherwise, the regulatory obligations highlighted in this advisory also apply, consistent with MSRB Rule D-11, to dealer's associated persons who engage in municipal securities activities on the dealer's behalf.

Questions about this advisory or other compliance topics may be directed to compliance@msrb.org.

Dealers may also subscribe to the MSRB email updates on the MSRB's website to ensure they receive information from the MSRB on upcoming events, compliance resources and news.

⁵ As noted, this resource does not address all regulatory obligations applicable to dealers pursuant to each MSRB rule or pursuant to other securities laws and regulations.

Compliance Considerations

MSRB Rules G-27: Supervision

[MSRB Rule G-27](#) requires a dealer to supervise the municipal securities activities of each registered representative, registered principal, and other associated person. A dealer is required to adopt, maintain and enforce written supervisory procedures (WSPs) reasonably designed to ensure that the conduct of the municipal securities activities of the dealer and its associated persons are in compliance with applicable securities laws and regulations, and MSRB rules. Such WSPs shall, at a minimum, establish procedures that state how a designated principal shall monitor for compliance with applicable rules and supervise the municipal securities activities of the firm and its associated persons.

Compliance Considerations May Include:

- Does the firm have a process for amending policies and procedures to reflect changes in applicable rules and the municipal securities activities in which it engages?
- Does the firm have a process to promptly communicate any amended policies and procedures to the associated persons to whom such policies and procedures are relevant based on their activities and responsibilities?
- Do the WSPs specify the frequency by which the designated principal(s) undertake the supervisory tasks?
- Do the WSPs identify the document(s) the designated principal(s) may review or create to indicate that they have undertaken the assigned supervisory tasks?
- If the firm engages in municipal advisory activities and relies on an exemption or exclusion from registration as a municipal advisor, does the firm have procedures that address its determination for qualifying for an exemption or exclusion?

MSRB Rules G-15 and G-30: Confirmation Disclosures & Fair and Reasonable Pricing and Mark-Ups

[MSRB Rule G-15](#) generally requires dealers to provide customers with written confirmations of transactions, containing specified information and prescribes certain uniform practice procedures for dealers that transact with customers. Among other disclosures specified in Rule G-15, dealers must disclose on certain retail customer confirmations (as described in Rule G-15(a)(i)(F)) the amount of the mark-up or mark-down charged (specified as a total dollar amount and as a percentage of the prevailing market price) on

the transaction. In addition, dealers must disclose the time of execution for all transactions, including principal and agency transactions. However, for transactions in municipal fund securities and transactions for institutional customers, rather than disclosing the time of execution, dealers instead may include on the confirmation a statement that the time of execution will be furnished upon written request. Further, dealers must disclose a security-specific URL on all retail customer confirmations, other than transactions in municipal fund securities.

MSRB Rule G-30 requires dealers to effect transactions in municipal securities with customers at fair and reasonable prices or commissions, as applicable, taking into account all relevant factors. Rule G-30 also requires dealers to use reasonable diligence to determine the prevailing market price (PMP) of a security consistent with Rule G-30 and supplementary materials (SM) .06. Under the standard of reasonable diligence, dealers may rely on reasonable policies and procedures to facilitate PMP determination, as long as the policies and procedures are consistent with Rule G-30 and are consistently applied. Under SM .06, the PMP of a municipal security generally will be presumptively established by referring to the dealer's contemporaneous cost (in the case of a dealer sale to a customer) or contemporaneous proceeds (in the case of a dealer buy from a customer) (the "presumption"). There is no specific time-period that is categorically "contemporaneous." If a dealer uses a time period as a proxy for what it will view as "contemporaneous," the development of that proxy must not be arbitrary and must be based on the dealer's exercise of reasonable diligence. Additionally, the proxy must be consistently applied.

The presumption may be overcome in limited circumstances set forth in SM .06. If the presumption is overcome or is not applicable because the dealer's cost or proceeds are not contemporaneous, three additional categories of factors may be considered to determine the PMP. The three additional categories of factors are: (1) a hierarchy of pricing factors; (2) information regarding similar securities; and (3) economic models. Generally, a subsequent factor or series of factors may be considered only if previous factors are inapplicable, as specified in the provisions governing the category.

Compliance Considerations May Include:

- Do the procedures describe the firm's process for identifying similar securities for purposes of G-30?
- Do the procedures describe the firm's process for determining PMP (*e.g.*, end of day, at the time of trade or some time in between)?
- Does the firm have a process to monitor the confirmation generation process to determine that the disclosures are made and made in a manner consistent with Rule G-15?

- Does the firm have a process, if applicable, to assess the services of a vendor before engagement and for monitoring the services if engaged?

MSRB Rule G-18: Best Execution

[MSRB Rule G-18](#) requires a dealer to use reasonable diligence to ascertain the best market for a subject security and buy or sell in that market so that the resulting price to the customer is as favorable as possible under the prevailing market conditions. Failure to obtain the most favorable price possible will not necessarily mean that the dealer failed to use reasonable diligence in determining the best market in the security. Each transaction requires a “facts and circumstances” analysis and actions that may meet the best execution standard in one situation may not meet the standard under another set of circumstances. In order to meet the best execution standard, a dealer must have sound policies and procedures reasonably designed to achieve best execution and periodically review and revise them, as needed.

Compliance Considerations May Include:

- Do the procedures describe the firm’s process to ascertain the best market for the security and the frequency for evaluating whether that process remains reasonable?
- If the firm routes its orders to another dealer that has agreed to execute those transactions, do the procedures indicate the process for evaluating the other dealer’s best execution reviews and the frequency of such reviews?
- If a dealer uses filters, do the procedures describe the factors considered when establishing, modifying and removing filters (*e.g.*, a counterparty is the source of regular fails and/or other regulatory concerns) and, if so, how such factors are determined?

MSRB Rule G-11: Primary Offering Practices

[MSRB Rule G-11](#) establishes terms and conditions for sales by dealers of new issues of municipal securities in primary offerings, including provisions on priority of customer orders. In the case of a primary offering for which a syndicate has been formed, the syndicate shall establish priority provisions. Unless otherwise agreed to with the issuer, the priority provisions must give priority to customer orders over orders by members of the syndicate for their own accounts (*i.e.*, stock orders) or for their related accounts. The senior syndicate manager is required to inform syndicate members in writing of, among other things, the priority provisions, including, if applicable, the issuer’s retail order period requirements. A syndicate may permit a syndicate manager(s) to allocate municipal securities in a manner that is different from

the priority provisions if the syndicate manager(s) determine that doing so is in the best interest of the syndicate. If the syndicate manager(s) do change the priority provisions, prompt written notice must be provided to the other members of the syndicate and, if applicable, the selling group.

Compliance Considerations May Include:

- Do the procedures describe how the firm, if acting as a senior syndicate manager, undertakes to provide the requisite disclosures to syndicate members on a timely basis (*e.g.*, the amount of any portion of the take-down directed to each member by the issuer)?
- With respect to orders submitted during a retail order period, do the firm's procedures describe the process for determining if an order is from a customer that meets the issuer's eligibility criteria for participation in the retail order period?
- With respect to orders submitted during a retail order period, do the firm's procedures describe the process for making a written submission to the senior manager (or sole underwriter, as applicable) that indicates:
 - The order's eligibility for participation in the retail order period
 - Whether the order is one for which a customer is already conditionally committed
 - Whether the dealer has received more than one order from the retail customer for a security for which the same CUSIP number has been assigned
 - Identifying information required by the issuer or the senior manager on the issuer's behalf (but not including customer names or social security numbers); and
 - The par amount of the order

MSRB Rule G-19: Suitability of Recommendations and Transactions

[MSRB Rule G-19](#) requires a dealer to 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 dealer to ascertain the customer's profile.⁶ 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

⁶ Rule G-19 is composed of three main suitability obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability. See Rule G-19 SM .05, Components of Suitability Obligations.

other information the customer may disclose to the dealer in connection with such recommendation.

Compliance Considerations May Include:

- Do the procedures describe the firm’s process for determining reasonable-basis suitability?
- Do the procedures describe the firm’s process for determining customer-specific suitability?
- Do the procedures describe the firm’s process for determining quantitative suitability?
- Does the firm have a process for establishing a reasonable basis that the customer has the financial ability to invest in the recommended transaction?
- Does the firm have a process for documenting when one or more factors of a customer’s investment profile is not relevant in light of the facts and circumstances of the particular case?

MSRB Rule G-23: Standards of Conduct in the Performance of Financial Advisory Activities

[MSRB Rule G-23](#) prohibits a dealer from acting as a financial advisor to a municipal entity client on a new bond issue and subsequently switching roles to act as an underwriter on the same issuance. A dealer that clearly identifies itself in writing as an underwriter at the earliest stages of the relationship with the issuer will not be viewed as a financial advisor for purposes of Rule G-23. The dealer must conduct itself in a way that is consistent with an arm’s length relationship with the issuer in connection with this issue.

Pursuant to Rule G-23(c), a dealer acting as a financial advisor must evidence the advisory relationship in writing prior to, upon or promptly after the dealer has commenced the advisory relationship with the provision of consultant or financial advisory services. However, even in the absence of the requisite writing, a financial advisory relationship will be deemed to exist if the dealer renders financial advisory or consultant services to or on behalf of an issuer with respect to the issuance of securities, including advice on the structure, timing, terms and other similar matters regarding such issue.

Compliance Considerations May Include:

- Does the firm have a process for providing an issuer, at the earliest stages of the firm’s relationship with the issuer with respect to that issue, written notification of the firm’s role as a consultant or financial advisor or, in the alternative, as an underwriter?

- Do the procedures describe the firm’s process for ensuring the written financial advisory agreement includes the requisite information consistent with Rule G-23?
- Recognizing that the provision of financial advisory services may cause the firm to be a “municipal advisor” under the Securities Exchange Act of 1934 and the rules promulgated thereunder, does the firm have a process to ensure it does not engage in municipal advisory activities unless it is registered or exempt from registration?

Resources

Selected compliance resources applicable to relevant MSRB rules are listed below. To access additional compliance resources, visit the [Compliance Center](#) on the MSRB’s website at MSRB.org. [Subscribe to MSRB email updates](#) on the MSRB’s website to receive information from the MSRB on upcoming events, compliance resources and news. Choose the “Compliance Tip of the Week” email subscription option to receive a weekly compliance tip in your inbox. Additionally, the MSRB hosts [virtual compliance workshops](#). To submit questions in advance of any workshop or to suggest topics for future workshops, email MSRBEvents@msrb.org.

➤ **[MSRB Rule G-11](#): Primary Offering Practices**

[MSRB Regulatory Notice 2017-19 Request for Comment on a Concept Proposal Regarding Amendments to Primary Offering Practices of Brokers, Dealers and Municipal Securities Dealers \(September 14, 2017\)](#)

[Issuer Considerations for Distributing Bonds: Establishing Priority of Orders](#)

[Webinar - Primary Offering Practices: Overview of Amended Rule G-11](#)

[MSRB Notice 2012-13 Request for Comment on Proposed Rule Amendments and Interpretive Notice on Retail Order Periods \(March 6, 2012\)](#)

[MSRB Notice 2012-50 Request for Comment on Revised Draft Rule Amendments and a Revised Draft Interpretive Notice on Retail Order Periods \(October 2, 2012\)](#)

➤ **MSRB Rules [G-15](#) and [G-30](#): Confirmation Disclosures & Fair and Reasonable Pricing and Mark-Ups**

[MSRB Provides Investor Education Resources on New Mark-Up Disclosure Requirements \(April 4, 2018\)](#)

[Resource on Disclosing Mark-ups and Determining Prevailing Market Price](#)

[Confirmation Disclosure and Prevailing Market Price Guidance: Frequently Asked Questions](#)

➤ **[MSRB Rule G-18: Best Execution](#)**

[MSRB Reminds Dealers of Existing Guidance on Filtering of Bids and Offers \(January 3, 2018\)](#)

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[Implementation Guidance on MSRB Rule G-18, on Best Execution](#)

[Best Execution, the Investor's Perspective](#)

[Notice to Dealers that Use the Services of Broker's Brokers \(December 22, 2012\)](#)

➤ **[MSRB Rule G-19: Suitability of Recommendations and Transactions](#)**

[Suitability and Time-of-Trade Disclosure for Municipal Securities Transactions](#)

➤ **[MSRB Rule G-23: Activities of Financial Advisors](#)**

[Compliance Advisory for Brokers, Dealers and Municipal Securities Dealers \(September 2017\)](#)

[MSRB Rules: Essentials for Issuers](#)

➤ **Information from the Examining Authorities**

In addition to examining for compliance with MSRB rules, the examining authorities bring enforcement matters involving asserted violations of MSRB rules and other federal securities laws. Regulated entities often find the descriptions of these matters, and the published material on the examining authority's website regarding such matters, to be informative of the kinds of fact patterns that may give rise to an enforcement action. Information from the examining authorities is available at:

- [Securities and Exchange Commission's Office of Municipal Securities](#)
- [Financial Industry Regulatory Authority's Disciplinary Actions Online](#)
- [Federal Deposit Insurance Corporation](#)
- [Federal Reserve System](#)
- [Office of the Comptroller of the Currency](#)