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Affected Rules
[Rule G-48](#), [Rule D-15](#)

Interpretive Notice on the Application of MSRB Rules to Transactions in Managed Accounts

Background

Representatives of brokers, dealers and municipal securities dealers (collectively, “dealers”) have increasingly inquired about the application of certain Municipal Securities Rulemaking Board (MSRB) rules to managed accounts in which a registered investment adviser (“RIA”) is exercising discretion to buy and sell municipal securities on behalf of the account holder. Specifically, dealers have asked whether, with respect to these transactions, they are expected to:

- 1) Provide the time-of-trade disclosures required by MSRB Rule G-47 to the ultimate investor, who is the account holder (*i.e.*, the RIA’s client), particularly if the dealer does not know the identity of the investor; and
- 2) Obtain a customer affirmation from such an investor for purposes of qualifying the person, separately, as a sophisticated municipal market professional (“SMMP”) under MSRB Rule D-15, and owing the modified obligations under MSRB Rule G-48, on transactions with SMMPs, if the RIA is itself an SMMP.¹

This notice provides background information on the relevant rules, analyzes the questions presented and provides interpretive guidance in response.

Relevant Rules

The principal rules relevant to these interpretive questions are Rules G-47, D-15, and G-48.

¹ Although the specific inquiries focused on the applicability of Rule G-47, MSRB Rule G-18, on best execution, and the exemption from Rule G-18 when executing transactions for or with an SMMP, this interpretive guidance applies to all the modified obligations under Rule G-48, as discussed herein.



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MSRB Rule G-47 – Time of Trade Disclosure

Rule G-47 sets forth the general time-of-trade disclosure obligation applicable to dealers. Specifically, pursuant to Rule G-47, a dealer cannot sell municipal securities to a customer, or purchase municipal securities from a customer, without disclosing to the customer, at or prior to the time of trade, all material information known about the transaction and material information about the security that is reasonably accessible to the market. The rule applies regardless of whether the transaction is unsolicited or recommended, occurs in a primary offering or the secondary market, and is a principal or agency transaction. The disclosure can be made orally or in writing.

Information is “material” if there is a substantial likelihood that the information would be considered important or significant by a reasonable investor in making an investment decision. The rule defines “reasonably accessible to the market” as information that is made available publicly through “established industry sources.”² Finally, the rule defines “established industry sources” as including EMMA, rating agency reports, and other sources of information generally used by dealers that effect transactions in the type of municipal securities at issue. Under these standards, “material information” encompasses a complete description of the security, which includes a description of the features that would likely be considered significant by a reasonable investor, and facts that are material to assessing potential risks of the investment.

MSRB Rule D-15 – Sophisticated Municipal Market Professional

Rule D-15 defines the set of customers that may be SMMPs” as (1) a bank, savings and loan association, insurance company, or registered investment company; (2) an RIA; or (3) any other person or entity with total assets of at least \$50 million. To qualify as an SMMP under the rule, the dealer must have a reasonable basis to believe the customer is capable of independently evaluating investment risks and market value, in general and with respect to particular transactions and investment strategies in municipal securities. In addition, the customer is required to affirm that it is exercising independent judgment in evaluating the quality of execution of the customer’s transactions by the dealer. Further, the customer is required to affirm that it

² The public availability of material information through the MSRB’s Electronic Municipal Market Access (EMMA[®]) system, or other established industry sources, does not relieve dealers of their disclosure obligations, and dealers may not satisfy the disclosure obligation by directing customers to established industry sources or through disclosure in general advertising materials.

is exercising independent judgment in evaluating the transaction price in non-recommended agency secondary market transactions where the dealer's services are explicitly limited to providing anonymity, communication, order matching and/or clearance functions, and the dealer does not exercise discretion as to how or when the transactions are executed. Finally, the customer is required to affirm that it has timely access to "material information" available publicly from "established industry sources" as those terms are defined in Rule G-47. The customer affirmation may be given orally or in writing, and may be given on a transaction-by-transaction basis, a type-of-municipal security basis, an account-wide basis or a type-of-transaction basis.

Importantly, the definition of SMMP under Rule D-15 is not self-executing, nor are the contingencies for its application solely controlled by the dealer. Rather, classification as an SMMP requires the customer to make the affirmation noted above. Consequently, any customer, even if otherwise qualifying as an SMMP, could choose not to make the affirmation in order to obtain the benefits of those obligations that otherwise would be modified (*e.g.*, best execution). Overall, the customer affirmation requirement is designed to ensure that SMMPs have affirmatively and knowingly agreed to forgo certain protections under MSRB rules.

MSRB Rule G-48 – Transactions with Sophisticated Municipal Market Professionals

Rule G-48 addresses modified obligations of dealers when dealing with SMMPs. It relieves dealers of the time-of-trade disclosure obligation under Rule G-47 for information reasonably accessible to the market, the pricing obligations under MSRB Rule G-30 under certain circumstances,³ the customer-specific suitability obligation under MSRB Rule G-19,⁴ certain

³ The pricing obligations under Rule G-30 are modified only when the transactions are non-recommended secondary market agency transactions; the dealer's services with respect to the transactions have been explicitly limited to providing anonymity, communication, order matching, and/or clearance functions; and the dealer does not exercise discretion as to how or when the transactions are executed.

⁴ The customer-specific suitability obligation requires that a dealer have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile. See Supplementary Material .05(b) to Rule G-19. Rule G-48 does not relieve dealers of the obligations regarding reasonable-basis and quantitative suitability. See Supplementary Material .05(a) and (c) to Rule G-19.

obligations with respect to the dissemination of quotations under MSRB Rule G-13,⁵ and the best-execution obligation under Rule G-18.⁶

Interpretive Guidance

The rules referenced above, including Rule G-48 on certain modified obligations, are, or relate to the application of, various investor/customer protections. As such, a threshold approach to the interpretive questions is to focus on who the dealer's customer is, and, thus, to whom the dealer owes these protections when an RIA has full discretion over investor clients' accounts.

According to past guidance, there are facts and circumstances under which the MSRB considers the RIA, and not the underlying investors, to be the dealer's customer. When an independent investment adviser (including an RIA) purchases securities from one dealer and instructs that dealer to make delivery of the securities to other dealers where the investment adviser's clients have accounts, and the identities of individual account holders are not given to the delivering dealer, the investment adviser is the customer of the dealer and must be treated as such for recordkeeping and other regulatory purposes.⁷ Accordingly, in those scenarios, the dealer does not have any customer obligations to the underlying investors.

Even if the underlying investors are, or are considered to be, customers of the dealer, the MSRB interprets Rule G-48 to mean, under certain circumstances, that the obligations modified by that rule are modified with respect to the underlying investors, as well as the RIA that is an SMMP. Specifically, when an investor has granted an RIA full discretion to act on the investor's behalf for all transactions in an account, the RIA has effectively become that investor for purposes of the application of Rule G-48 when engaging in transactions with the dealer. Therefore, if that RIA is an SMMP, to whom the dealers' obligations are modified under Rule G-48, then, for purposes of complying with the rules addressed in Rule G-48, the dealer

⁵ As modified by Rule G-48, if a dealer is disseminating a quotation on behalf of an SMMP, the dealer shall have no reason to believe the quotation does not represent a bona fide bid for, or offer of, municipal securities, or that the price stated in the quotation is not based on the best judgment of the fair market value of the securities of the SMMP, and no dealer shall knowingly misrepresent a quotation relating to municipal securities made by any SMMP.

⁶ Under Rule G-18, in any transaction for or with a customer or a customer of another dealer, a dealer must 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 customer is as favorable as possible under prevailing market conditions.

⁷ See [MSRB Notice 2003-20](#) (May 23, 2003); [Interpretive Notice on Recordkeeping](#) (Jul. 29, 1977).

should not be required to satisfy any greater or additional obligations with respect to the ultimate investor who holds that account. When the MSRB included RIAs in the set of customers that may be SMMPs, it was, of course, aware that RIAs typically act on behalf of third-party clients. It would have been anomalous for Rule G-48 to modify the dealers' obligations to an RIA that is an SMMP, only essentially to re-impose them on the dealer with respect to the underlying investors who have given the RIA full discretion to act on their behalf.

This interpretation, under which dealer obligations to certain investors would be modified, is supported by the existence (where the conditions of the interpretation are met) of substantially similar federal and/or state obligations. For example, RIAs registered with the SEC are subject to the Investment Advisers Act of 1940 ("Advisers Act") and the rules thereunder, including a fiduciary duty extending to all services undertaken on behalf of clients.⁸ Obligations flowing from the fiduciary duty, include, but are not limited to, the requirements to:

- Provide full disclosure of material facts, including conflicts of interest and disciplinary events and precarious financial condition;⁹
- Give suitable advice;¹⁰
- Have a reasonable basis for recommendations;¹¹ and
- Meet best-execution obligations.¹²

⁸ See [SEC Study on Investment Advisers and Broker-Dealers](#) (January 2011) at 21 ("The Supreme Court has construed Advisers Act Section 206(1) and (2) as establishing a federal fiduciary standard governing the conduct of advisers.") ("IA-BD Study"). See also *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963); *Transamerica Mortgage Advisors, Inc.*, 444 U.S. 11, 17 (1979) ("[T]he Act's legislative history leaves no doubt that Congress intended to impose enforceable fiduciary obligations.").

⁹ See IA-BD Study at 22 ("[A]n adviser must fully disclose to its clients all material information that is intended 'to eliminate, or at least expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.'").

¹⁰ "To fulfill the obligation, an adviser must make a reasonable determination that the investment advice provided is suitable for the client based on the client's financial situation and investment objectives." *Id.* at 27-28.

¹¹ "[A]n investment adviser has 'a duty of care requiring it to make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information.'" *Id.* at 28.

¹² For accounts in which investment advisers exercise discretion, they generally have the responsibility to select dealers to execute client trades. *Id.* "In meeting this obligation, an

These and other investor protections provided by the regulatory regime under the Advisers Act reduce the need for the similar investor protections provided by time-of-trade disclosure, customer-specific suitability, best execution and the other obligations required by MSRB rules but modified under Rule G-48.¹³ Additionally, where an investor has affirmatively and in writing authorized the RIA to exercise full discretion in the investor's account, the investor has delegated decision-making authority over what to buy and sell in the account. Finally, the MSRB notes that, where the RIA is an SMMP, the RIA has affirmed and the dealer has a reasonable basis to believe that the RIA has the sophistication to obviate the need for the protections flowing from the obligations modified under Rule G-48, which the MSRB believes is also indicative of the RIA's ability to provide similar protections to its clients when a dealer is not required to do so. When combining the investor protections afforded by substantially similar federal or state regulatory requirements for RIAs, the full discretionary power affirmatively provided to an RIA, and the RIA's status as an SMMP, there is sufficient protection afforded to the account holders, who are the RIA's clients, and, therefore, for purposes of the application of the rules modified by Rule G-48, dealers do not owe these underlying account holders any greater or additional obligations than those which apply to the RIA.¹⁴

Questions concerning this notice may be directed to Carl E. Tugberk, Assistant General Counsel, at 202-838-1500.

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adviser must seek to obtain the execution of transactions for each of its clients in such a manner that the client's total cost or proceeds in each transaction are the most favorable under the circumstances." *Id.* "An investment adviser should 'periodically and systematically' evaluate the execution it is receiving for clients." *Id.* at 29.

¹³ The MSRB also believes that state rules and regulations for investment advisers offer similar protections that support the MSRB's interpretations here. Although the requirements are not uniform, "[s]tates generally impose requirements upon state-registered investment advisers that are similar to those under the Advisers Act." *Id.* at 85. *See also* Scott J. Lederman, *Hedge Fund Regulation* (2d Ed.), Ch. 17. State Advisory Regulation, 17-3 (Nov. 2012) ("State securities regulators generally impose requirements on state-registered advisers that are similar to those found in the Advisers Act. However, state regulation often contains additional requirements not found at the federal level.").

¹⁴ The MSRB notes that implicit in this interpretation is the expectation of dealers' compliance with all existing recordkeeping requirements associated with the various conditions for the interpretation's applicability.