SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-76420; File No. SR-MSRB-2015-03)

November 10, 2015

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Amendment No. 2 to Proposed Rule Change Consisting of Proposed New Rule G-42, on Duties of Non-Solicitor Municipal Advisors, and Proposed Amendments to Rule G-8, on Books and Records to be Made by Brokers, Dealers, Municipal Securities Dealers, and Municipal Advisors

I. Introduction

On April 24, 2015, the Municipal Securities Rulemaking Board ("MSRB") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change consisting of proposed new Rule G-42, on duties of non-solicitor municipal advisors, and proposed amendments to Rule G-8, on books and records to be made by brokers, dealers, municipal securities dealers, and municipal advisors. The proposed rule change was published for comment in the Federal Register on May 8, 2015.[3] The Commission received fifteen comment letters on the proposal.[4] On June 16, 2015, the MSRB granted an extension of time for the Commission to act on the filing until August 6, 2015. On August 6, 2015, the Commission issued an order instituting proceedings ("OIP") under Section 19(b)(2)(B) of the Act[5] to determine whether to approve or disapprove the proposed rule change.[6] On August 12,

---

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

2 17 CFR 240.19b-4.

3 Exchange Act Release No. 74860 (May 4, 2015), 80 FR 26752 ("Notice"). The comment period closed on May 29, 2015.

4 Comment letters are available at www.sec.gov/comments/sr-msrb-2015-03/msrb201503.shtml.

5 15 U.S.C. 78s(b)(2)(B).

2015, the MSRB responded to the comments[7] and filed Amendment No. 1 to the proposed rule change.[8] In response to the OIP or Amendment No. 1, the Commission received 13 comment letters.[9] On October 28, 2015, the MSRB granted an extension of time for the Commission to act on the filing until January 3, 2016. On November 9, 2015, the MSRB filed Amendment No. 2 to the proposed rule change.[10] The text of Amendment No. 2 is available on the MSRB's website. The Commission is publishing this notice to solicit comments on Amendment No. 2 to the proposed rule change from interested persons.

---

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

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

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

9 Letters from Michael Nicholas, Chief Executive Officer, Bond Dealers of America ("BDA"), dated September 11, 2015 and November 4, 2015; John C. Melton, Sr., Executive Vice President, Coastal Securities ("Coastal Securities"), dated September 11, 2015; Jeff White, Principal, Columbia Capital Management, LLC ("Columbia Capital"), dated September 10, 2015; Joshua Cooperman, Cooperman Associates ("Cooperman"), dated September 9, 2015; David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute ("FSI"), dated September 11, 2015; Dustin McDonald, Director, Federal Liaison Center, Government Finance Officers Association ("GFOA"), dated September 14, 2015; Tamara K. Salmon, Associate General Counsel, Investment Company Institute ("ICI"), dated September 11, 2015; Lindsey K. Bell, Millar Jiles, LLP ("Millar Jiles"), dated September 11, 2015; Terri Heaton, President, National Association of Municipal Advisors ("NAMA"), dated September 11, 2015; Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association ("SIFMA"), dated September 11, 2015; Joy A. Howard, WM Financial Strategies ("WM Financial"), dated September 11, 2015; W. David Hemingway, Executive Vice President, Zions First National Bank ("Zions"), dated September 10, 2015.

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

II. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Amendment

The MSRB is proposing to add paragraphs .14 and .15 of the Supplementary Material to Proposed Rule G-42. Proposed paragraph .14 would provide a narrow exception ("Exception") to the proposed prohibition on certain principal transactions in Proposed Rule G-42(e)(ii) for transactions in specified types of fixed income securities. Proposed paragraph .15 would define those types of fixed income securities. Amendment No. 2 also makes five minor technical changes to clarify or renumber proposed rule text.[11]

Proposed Rule G-42 would establish core standards of conduct and duties of non-solicitor municipal advisors when engaging in municipal advisory activities. Proposed Rule G-42(a)(ii), consistent with the Exchange Act,[12] provides that a municipal advisor, in the conduct of all municipal advisory activities for a municipal entity client, is subject to a fiduciary duty that includes a duty of loyalty and a duty of care. Under proposed paragraph .02 of the Supplementary Material to Proposed Rule G-42, the duty of loyalty requires, among other things, a municipal advisor to act in the municipal entity client's best interest without regard to the financial or other interests of the municipal advisor. In light of this fiduciary duty, and to prevent acts, practices or courses of business inconsistent with this duty, Proposed Rule G-42(e)(ii) would prohibit a municipal advisor, and any affiliate of such municipal advisor, from engaging with its municipal entity client in a principal transaction that is the same, or directly related to the, municipal securities transaction or municipal financial product as to which the municipal

---

11 The MSRB will address issues raised in the comment letters received in response to the OIP or Amendment No. 1 that are not addressed through this Amendment No. 2 concurrently with its response to comment letters received, if any, in response to this Amendment No. 2.

12 See Section 15B(c)(1) of the Exchange Act (15 U.S.C. 78o-4(c)(1)).

advisor is providing or has provided advice to the municipal entity client ("principal transaction ban" or "ban").

The comment letters in response to the OIP or Amendment No. 1 that addressed the principal transaction ban generally expressed concerns about the breadth of the ban and the lack of any exception. They noted that fiduciaries governed by other regulatory regimes, such as investment advisers under the Investment Advisers Act of 1940 ("Advisers Act"),[13] are not flatly prohibited from engaging in principal transactions with their clients if proper disclosures are made and consent is obtained. Several commenters, including GFOA, FSI, SIFMA and BDA, generally urged the inclusion of an exception in cases, at a minimum, where the advice provided is in connection with the execution of a securities transaction by the municipal advisor on behalf of the municipal entity, the principal transaction is in a fixed income security, and the municipal entity client is involved in the process for the management of the relevant conflicts of interest. GFOA expressed concerns that the ban "could force small governments to open a more expensive fee-based arrangement with an outside advisor in order to receive this very limited type of advice on investments that are not considered to be risky."[14] Several other commenters, including BDA, FSI, Millar Jiles, SIFMA and Zions, commented on the importance of preserving a municipal entity's choices and access to services and products at favorable prices, preserving choices regarding financial advisors with whom they had relationships of trust, and avoiding increased costs to municipal entities.

---

13 15 U.S.C. 80b-1 et seq.

14 GFOA, however, acknowledged that the ban would be appropriate in the context of a traditional financial advisor.

Prior to the most recent set of comments, the MSRB consistently concluded that the principal transaction ban should be retained with the breadth as proposed. After carefully considering the additional comments, including those of GFOA, generally representative of a key class of entities that Proposed Rule G-42 is intended to protect, the MSRB has determined to incorporate the Exception into Proposed Rule G-42. The MSRB believes that the Exception will address the primary concerns expressed by commenters that, without an exception for transactions in certain fixed income securities when advice is given by the municipal advisor in connection with executing such transactions, the proposed ban would restrict the access of municipal entities to trusted financial advisors, limit their ability to obtain certain financial services and products, create undue burdens on competition, and impose unjustified costs for issuers.

Significantly, the MSRB has developed Proposed Rule G-42 as a cornerstone of a regulatory framework that recognizes and is tailored to the unique characteristics of the municipal securities market, the special responsibilities of municipal entities in their financial matters and in their relationship to their constituents, and the particular role that municipal advisors play in the municipal securities market. The design of the proposed rule, as amended by Amendment No. 2, is in recognition that municipal advisors serve a diverse array of clients, and, in particular, municipal entity clients, which range from large state issuers to small school districts, special districts and other instrumentalities, public pension plans, and collective vehicles, such as local government investment pools ("LGIPs") and college savings plans that comply with Section 529 of the Internal Revenue Code.[15] The design of the proposed rule is also in recognition that municipal entity clients may have special needs of access to a range of

[15] See 26 U.S.C. 529.

services and particular types financial products from municipal advisors and affiliated financial intermediaries. At the same time, the MSRB believes that the proposed rule change, as amended, will further the protection of municipal entities, investors and the public interest.

Description. The Exception, to be incorporated as new proposed paragraph .14 of the Supplementary Material to Proposed Rule G-42, would provide a municipal advisor two options by which it might engage in certain principal transactions with a municipal entity client, provided the municipal advisor also complies with the first three requirements set forth in paragraph .14 (organized as sections (a) through (c)). A municipal advisor would have the option to act, on a transaction-by-transaction basis, in accordance with a short set of procedural requirements, some of which are drawn from and similar to the requirements set forth in Advisers Act Section 206(3).[16] Alternatively, a municipal advisor that wishes to satisfy procedural requirements on other than a transaction-by-transaction basis would be subject to more and different procedural requirements, including obtaining from the municipal entity client a prospective blanket, written consent. These procedural requirements are drawn from and similar to those set forth in Advisers Act Rule 206(3)-3T.[17]

Importantly, the Exception would operate only to take certain conduct out of the specified prohibition on certain principal transactions in proposed Rule G-42(e)(ii). It would not provide a safe harbor from complying with any other applicable law or rules. Thus, a municipal advisor engaging in a principal transaction in compliance with the Exception would need to continue to be mindful of, and comply with, its broader and foundational obligations owed to the client as a

---

16 15 U.S.C. 80b-6(3).

17 17 CFR 275.206(3)-3T.

fiduciary under the Exchange Act and Proposed Rule G-42, as well as all other applicable provisions of the federal securities laws and state law.[18]

All of the requirements for the Exception take the form of various conditions and limitations. As provided in proposed section (a) of paragraph .14 of the Supplementary Material, a principal transaction could be excepted from the specified prohibition only if the municipal advisor also is a broker-dealer registered under Section 15 of the Exchange Act,[19] and each account for which the municipal advisor would be relying on the Exception is a brokerage account subject to the Exchange Act,[20] the rules thereunder, and the rules of the self-regulatory organizations(s) of which the broker-dealer is a member. In addition, the municipal advisor could not exercise investment discretion (as defined in Section 3(a)(35) of the Exchange Act)[21] with respect to the account, unless granted by the municipal entity client on a temporary or limited basis.[22]

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

---

18 The MSRB's approach in this regard is consistent with that of the Commission with respect to principal transactions executed by investment advisers under Advisers Act Section 206(3) (15 U.S.C. 80b-6(3)) or Advisers Act Rule 206(3)-3T (17 CFR 275.206(3)-3T).

19 15 U.S.C. 78o.

20 15 U.S.C. 78a et seq.

21 15 U.S.C. 78(c)(a)(35).

22 The proposed requirements are similar to those found in Advisers Act Rule 206(3)-T(a)(7) and (1), respectively. 17 CFR 275.206(3)-3T(a)(7) and (1).

principal transaction that also meets all the other requirements of proposed paragraph .14. For example, a municipal advisor could not use the Exception to reinvest proceeds from an issue of municipal securities where it was a municipal advisor as to such issue. A municipal advisor could use the Exception, however, for two principal transactions with the same municipal entity client where the transactions are directly related to one another, so long as all of the conditions and limitations of the Exception are met as to each transaction.

Proposed section (c) of paragraph .14 of the Supplementary Material would limit a municipal advisor's principal transactions under the Exception to sales to or purchases from a municipal entity client of any U.S. Treasury security, agency debt security or corporate debt security. In addition, the proposed Exception would not be available for transactions involving municipal escrow investments as defined in Exchange Act Rule 15Ba1-1(h)[23] because the MSRB believes that this is an area of heightened risk where, historically, significant abuses have occurred. The inclusion in the Exception of transactions in this class of fixed income securities is intended to address the concerns of commenters that an absolute ban on principal transactions in fixed income securities, which are frequently sold by broker-dealers as principal or riskless principal, would be particularly problematic, and also addresses comments that an exception limited to these generally relatively liquid securities trading in relatively transparent markets would raise significantly less risk for municipal entity clients.[24] The proposed class of securities

---

23 17 CFR 240.15Ba1-1(h).

24 For example, SIFMA noted the need for an exception to the ban was particularly acute with respect to transactions between a municipal advisor/broker-dealer and its municipal entity client in fixed income securities since "nearly all transactions in fixed-income securities are effected on a principal basis." GFOA noted that municipal entities might be subject to additional costs regarding advice on "investments that are not considered to be risky," and FSI specifically suggested that an exception to the ban for broker-dealers

may be broader than what would be permitted by relevant bond documents or a particular municipal entity's investment policies, but, in such cases, the restrictions in the bond documents or the municipal entity's investment policies would appropriately control. The terms "U.S. Treasury security," "agency debt security" and "corporate debt security," and related terms, "agency," "government-sponsored enterprise," "money market instrument" and "securitized product" would be defined for purposes of proposed paragraphs .14 and .15 of the Supplementary Material in new proposed paragraph .15 of the Supplementary Material.

To comply with proposed section (d) of paragraph .14 of the Supplementary Material, a municipal advisor would have two options. These two options draw, as generally urged by commenters, upon the procedural requirements in Advisers Act Section 206(3)[25] and Advisers Act Rule 206(3)-3T(a),[26] respectively. Under the first option, which is set forth in proposed subsection (d)(1) of paragraph .14, a municipal advisor would be required, on a transaction-by-transaction basis, to disclose to the municipal entity client in writing before the completion of the principal transaction the capacity in which the municipal advisor is acting and obtain the consent of the client to such transaction. Consent would mean informed consent, and in order to make informed consent, the municipal advisor, consistent with its fiduciary duty, would be required to disclose specified information, including the price and other terms of the transaction, as well as the capacity in which the municipal advisor would be acting. "Before completion" would mean

---

providing advice incidental to securities execution services be limited to transactions in a similar group of fixed income securities.

25 15 U.S.C. 80b-6(3).

26 See 17 CFR 275.206(3)-3T(a).

either prior to execution of the transaction, or after execution but prior to the settlement of the transaction.[27]

Alternatively, a municipal advisor could comply with proposed subsection (d)(2) of paragraph .14 by meeting six requirements, as set forth in proposed paragraphs (d)(2)(A) through (F) of paragraph .14 and summarized below. First, under proposed paragraph (d)(2)(A), neither the municipal advisor nor any of its affiliates could be the issuer, or the underwriter (as defined in Exchange Act Rule 15c2-12(f)(8)),[28] of a security that is the subject of the principal transaction.

Second, under proposed paragraph (d)(2)(B), the municipal advisor would be required to obtain from the municipal entity client an executed written, revocable consent that would prospectively authorize the municipal advisor directly or indirectly to act as principal for its own account in selling a security to or purchasing a security from the municipal entity client, so long as such written consent were obtained after written disclosure to the municipal entity client explaining: (i) the circumstances under which the municipal advisor directly or indirectly may engage in principal transactions; (ii) the nature and significance of conflicts with the municipal entity client's interests as a result of the transactions; and (iii) how the municipal advisor addresses those conflicts.

---

[27] These parameters are substantially similar to long-standing interpretive guidance regarding Advisers Act Section 206(3). See SEC Interpretation of Section 206(3) of the Investment Advisers Act of 1940, Rel. No. IA - 1732 (July 17, 1998) ("The protection provided to advisory clients by the consent requirement of Section 206(3) would be weakened, however, without sufficient disclosure of the potential conflicts of interest and the terms of a transaction. In our view, to ensure that a client's consent to a Section 206(3) transaction is informed, Section 206(3) should be read together with Sections 206(1) and 206(2) to require the adviser to disclose facts necessary to alert the client to the adviser's potential conflicts of interest in a principal . . . transaction.").

[28] 17 CFR 240.15c2-12(f)(8).

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

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

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

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

A municipal advisor's use and compliance with the requirements of the Exception would not be construed as relieving it in any way from acting in the best interests of its municipal entity client nor from any obligation that may be imposed by the Exchange Act, other provisions of

Proposed Rule G-42 (other than subsection (e)(ii) of the proposed rule), or other applicable provisions of the federal securities laws and state law.

Other Amendments

In Amendment No. 2, the MSRB makes five minor, technical amendments, which would clarify, correct cross-references in, or renumber certain provisions of Proposed Rule G-42. First, the MSRB is making minor, technical changes to Proposed Rule G-42(d) regarding recommendations. These amendments set forth the initial text that precedes proposed subsection (d)(i) in two sentences rather than one. The purpose of this change is to clarify the requirements that would apply when a municipal advisor makes a recommendation of a municipal securities transaction or municipal financial product and when a municipal advisor reviews such a recommendation of another party. These amendments also clarify in the initial text that precedes proposed subsection (d)(i), consistent with Proposed Rule G-42(d)(ii), that a municipal advisor reviewing a recommendation of another party could determine that the recommended municipal securities transaction or municipal financial product is not suitable for the client.

Second, Amendment No. 2 revises proposed Rule G-42(e)(ii) to begin with the new clause, "Except as provided in paragraph .14 of the Supplementary Material of this rule," and then continue as previously proposed, except that the phrase "municipal securities transaction" is changed to "issue of municipal securities" in order to more closely track the relevant statutory language.[29] Third, to alphabetize the definitions set forth in proposed section (f), the proposed definition of the term "Principal transaction" is renumbered from subsection (f)(i) to subsection (f)(ix). The other eight definitions, set forth as subsections (f)(ii) through (f)(ix), are renumbered, accordingly, as subsections (f)(i) through (f)(viii). Fourth, in proposed paragraphs of the

[29] See, e.g., 15 U.S.C. 78o-4(b)(2).

Supplementary Material, references to "this paragraph" are amended to include the appropriate paragraph number (e.g., in proposed paragraph .01 of the Supplementary Material, "this paragraph" is amended to read "this paragraph .01"). Fifth, the order of proposed paragraphs .12 and .13 of the Supplementary Material is reversed, which organizes the two paragraphs addressing principal transactions to appear consecutively and improves the readability of the rule. In addition, in proposed paragraph .13 (as renumbered), the cross-reference to the definition of the term "principal transaction" is corrected.

The MSRB proposes to make the proposed rule change effective six months after Commission approval of all changes.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments regarding the foregoing, including whether the filing as amended by Amendment No. 2 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-MSRB-2015-03 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-MSRB-2015-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all

comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of the MSRB. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2015-03 and should be submitted on or before [insert date 14 days from publication in the Federal Register].[30]

For the Commission, pursuant to delegated authority.[31]

Robert W. Errett
Deputy Secretary

---

30 The Commission believes that a 14-day comment period is reasonable, given the urgency of the matter. It will provide adequate time for comment.

31 17 CFR 200.30-3(a)(12).