

it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule change should be approved or disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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 email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-ISE-2020-23 on the subject line.

##### *Paper Comments*

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090. All submissions should refer to File Number SR-ISE-2020-23. This file number should be included on the subject line if email 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 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish

to make available publicly. All submissions should refer to File Number SR-ISE-2020-23, and should be submitted on or before July 22, 2020.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>43</sup>

**J. Matthew DeLesDernier,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-89154; File No. SR-MSRB-2020-02]

### Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Granting Approval of a Proposed Rule Change To Align Certain MSRB Rules to Securities Exchange Act Rule 15/-1, Regulation Best Interest

June 25, 2020.

#### I. Introduction

On May 1, 2020, 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")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to align MSRB rules to the Commission's recently adopted Rule 15/-1 under the Exchange Act ("Regulation Best Interest");<sup>3</sup> specifically, amendments to MSRB Rule G-8 (on books and records), MSRB Rule G-9 (on preservation of records), MSRB Rule G-19 (on suitability of recommendations and transactions), MSRB Rule G-20 (on gifts, gratuities, non-cash compensation and expenses of issuance), MSRB Rule G-48 (on transactions with Sophisticated Municipal Market Professionals ("SMMPs")), and the deletion of an interpretation of MSRB Rule G-20 (the "proposed rule change").

The proposed rule change was published for comment in the **Federal Register** on May 12, 2020.<sup>4</sup> The public comment period closed on June 2,

2020.<sup>5</sup> As described further below, the Commission is approving the proposed rule change.

#### II. Description of Proposed Rule Change

As described further below, the MSRB proposed to align MSRB rules with Regulation Best Interest by revising the MSRB's rules to comport with Regulation Best Interest obligations involving: (i) Suitability, by amending MSRB Rule G-19 to apply only in circumstances in which Regulation Best Interest does not apply and eliminate the control element from the quantitative suitability obligation for recommendations subject to MSRB Rule G-19, and MSRB Rule G-48 to make clear that the exception from the requirement to perform a customer-specific suitability analysis when making a recommendation to a Sophisticated Municipal Market Participant ("SMMP") (as defined in MSRB Rule D-15) is available only for recommendations that are subject to MSRB Rule G-19; (ii) non-cash compensation, by updating MSRB Rule G-20 to require any permissible non-cash compensation to align with the applicable requirements of Regulation Best Interest; and (iii) books and records, by requiring dealers to maintain books and records required by Regulation Best Interest and the related SEC Form CRS requirement through revisions to MSRB Rules G-8 and G-9.

##### A. Background

On June 5, 2019, the SEC adopted Regulation Best Interest, which establishes a new standard of conduct for Broker-Dealers<sup>6</sup> and natural persons who are associated persons of a Broker-Dealer.

Specifically, this standard of conduct for a Broker-Dealer applies when making a recommendation to a retail customer, defined generally as a 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, of any securities transaction or investment strategy involving securities.<sup>7</sup> The Commission

<sup>5</sup> All comment letters received on the proposed rule change are available on the Commission's website at <https://www.sec.gov>.

<sup>6</sup> Under Regulation Best Interest, "broker-dealers" are defined as "broker-dealers and natural persons who are associated persons of a broker-dealer (unless otherwise indicated, together referred to as "broker-dealer[s]"). Regulation Best Interest Adopting Release, 84 FR at 33318. Each broker-dealer subject to Regulation Best Interest is referred to herein as a "Broker-Dealer" and, collectively as "Broker-Dealers."

<sup>7</sup> *Id.*

<sup>43</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 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").

<sup>4</sup> Securities Exchange Act Release No. 88829 (May 6, 2020) (the "Notice"), 85 FR 28082 (May 12, 2020) (MSRB-2020-02).

stated that Regulation Best Interest enhances the Broker-Dealer standard of conduct beyond existing suitability obligations, and aligns the standard of conduct with retail customers' reasonable expectations by imposing certain new requirements on Broker-Dealers.<sup>8</sup> Specifically, Regulation Best Interest imposes the following "general obligation" on Broker-Dealers:

[W]hen 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] making the recommendation ahead of the interest of the retail customer.<sup>9</sup>

Regulation Best Interest<sup>10</sup> 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");<sup>11</sup> (ii) an obligation to exercise reasonable diligence, care, and skill in making a recommendation (the "Care Obligation");<sup>12</sup> (iii) an obligation to establish, maintain, and enforce written policies and procedures reasonably designed to address conflicts of interest (the "Conflict of Interest Obligation");<sup>13</sup> 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").<sup>14</sup>

The MSRB stated that the following changes to its rules reflect its attempt to harmonize the MSRB's rules with Regulation Best Interest and Form CRS and reduce the potential for conflicting or duplicative regulation in the municipal securities market among Dealers.<sup>15</sup>

<sup>8</sup> Regulation Best Interest Adopting Release, 84 FR at 33319.

<sup>9</sup> 17 CFR 240.15l-1(a)(1).

<sup>10</sup> SEC staff frequently asked questions on Regulation Best Interest are available at: <https://www.sec.gov/tm/faq-regulation-best-interest>.

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

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

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

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

<sup>15</sup> To effect transactions in municipal securities, a person must be a Broker-Dealer subject to registration with the Commission under Section 15(b)(1) or a municipal securities dealer subject to registration with the Commission under Section 15B(a)(2) of the Exchange Act. See 15 U.S.C. 78f(b)(1); 15 U.S.C. 78o-4(b)(2)(C).

With respect to municipal securities dealers subject to registration under Section 15B(a)(2) of the

## B. Suitability

### i. MSRB Rule G-19

MSRB Rule G-19 provides that a Dealer must have a reasonable basis to believe that a recommended transaction or investment strategy involving municipal securities is suitable for the customer, based on the information obtained through the reasonable diligence of the Dealer to ascertain the customer's investment profile.<sup>16</sup> The MSRB Rule G-19 suitability standard is composed of three component obligations:

1. *Reasonable-basis suitability*, which requires a dealer to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors;<sup>17</sup>

2. *Customer-specific suitability*, which requires a dealer to have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile;<sup>18</sup> and

3. *Quantitative suitability*, which requires a dealer who has actual or *de facto* control over a customer account 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.<sup>19</sup>

MSRB Rule G-19 applies to all Dealers when making a recommendation to a "customer," which is defined in MSRB Rule D-9 as any person other than a Dealer acting in its capacity as a Dealer or an issuer in transactions involving the sale of a new issue of its securities.<sup>20</sup> When a Dealer

Exchange Act, MSRB Rule D-8 provides that "a municipal securities dealer which is a bank or a separately identifiable department or division of a bank" is a bank dealer ("Bank Dealer"). As used herein, a Bank Dealer, together with a Broker-Dealer is a "Dealer."

Bank Dealers are registered with the Commission under Exchange Section 15B(a)(2), and thus are *not* subject to Regulation Best Interest. Nevertheless, because Bank Dealers can make recommendations of municipal securities transactions or investment strategies involving municipal securities to retail customers, the Board stated it plans to issue a separate Request for Comment on whether the Board will apply the requirements of Regulation Best Interest, through further amendments to MSRB rules, to Bank Dealers. See Notice, 85 FR at 28083 n.5.

<sup>16</sup> MSRB Rule G-19 defines a customer's investment profile to include 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 dealer in connection with such recommendation.

<sup>17</sup> MSRB Rule G-19, Supplementary Material .05(a).

<sup>18</sup> MSRB Rule G-19, Supplementary Material .05(b).

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

<sup>20</sup> MSRB Rule D-9 states that, "Except as otherwise specifically provided by rule of the

reasonably concludes that a customer is an SMMP,<sup>21</sup> such Dealer is not obligated to perform a customer-specific suitability analysis under MSRB Rule G-19.<sup>22</sup>

Conceptually similar to MSRB Rule G-19, the Care Obligation of Regulation Best Interest also requires a three-part analysis to evaluate recommendations to retail customers but employs the higher best interest standard instead of MSRB Rule G-19's suitability standard.<sup>23</sup> In addition, while Regulation Best Interest applies only to recommendations to "retail customers," defined generally as a 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>24</sup> MSRB Rule G-19 applies to "customers" (with an exception to the customer-specific suitability requirement for recommendations to SMMPs).<sup>25</sup>

The proposed rule change includes two amendments to MSRB Rule G-19 designed to harmonize MSRB

Board, the term 'customer' shall mean any person other than a broker, dealer, or municipal securities dealer acting in its capacity as such or an issuer in transactions involving the sale by the issuer of a new issue of its securities."

<sup>21</sup> MSRB Rule D-15 defines a customer as an SMMP according to three elements:

(a) *Nature of the Customer*. The customer must be:

(1) a bank, savings and loan association, insurance company, or registered investment company;

(2) an investment adviser registered either with the Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or

(3) any other person or entity with total assets of at least \$50 million.

(b) *Dealer Determination of Customer Sophistication*. The dealer must have 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.

(c) *Customer Affirmation*. 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; and

(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).

<sup>22</sup> MSRB Rule G-48(c).

<sup>23</sup> See Notice, 85 FR at 28084.

<sup>24</sup> See 17 CFR 240.15l-1(b)(1).

<sup>25</sup> See Notice, 85 FR at 28084.

requirements with Regulation Best Interest.<sup>26</sup> First, to avoid unnecessary regulatory complexity, the applicability of MSRB Rule G–19 would be limited only to circumstances in which Regulation Best Interest does not apply.<sup>27</sup> Second, the proposed rule change would remove the existing limitation in MSRB Rule G–19 that requires a quantitative suitability determination only when a Dealer has “actual or *de facto* control” over the customer’s account.<sup>28</sup> These proposed amendments are discussed below.

a. Eliminate Applicability of MSRB Rule G–19 to Recommendations Subject to Regulation Best Interest

The MSRB stated that Regulation Best Interest addresses generally the same conduct that is addressed by MSRB Rule G–19 but employs a best interest, rather than a suitability, standard. The MSRB also stated that, absent action by the Board, a Broker-Dealer would be required to reconcile compliance with both Regulation Best Interest and MSRB Rule G–19 in many circumstances.<sup>29</sup> In such circumstances, the MSRB believed that compliance with Regulation Best Interest would result in compliance with MSRB Rule G–19 because a Broker-Dealer that “act[s] in the best interest of the retail customer”<sup>30</sup> when making a recommendation to a retail customer of any securities transaction or investment strategy involving securities would necessarily also meet the MSRB Rule G–19 requirement to “have a reasonable basis to believe that [the recommendation] is suitable for the customer.”<sup>31</sup>

The MSRB stated that the proposed rule change reduces the potential for duplicative regulation and unnecessary complexity and provides regulatory clarity about the applicability and requirements of MSRB Rule G–19 and Regulation Best Interest to market participants in an effective and efficient manner.<sup>32</sup> In particular, the proposed rule change adds new text to MSRB Rule G–19 that states that MSRB Rule G–19 does not apply to recommendations subject to Regulation Best Interest.<sup>33</sup> MSRB Rule G–19 would thus apply only to:

1. Recommendations to customers that are not “retail customers,”<sup>34</sup> as defined by Regulation Best Interest; and
2. Recommendations to any customers by Bank Dealers.<sup>35</sup>

b. Align MSRB Rule G–19’s Quantitative Suitability Obligation to the Requirements of Regulation Best Interest

MSRB Rule G–19’s quantitative suitability obligation requires a Dealer to have a reasonable basis for believing that a series of recommended transactions are not excessive and unsuitable for the customer when taken together in light of the customer’s profile, but only if the Dealer has actual or *de facto* control over the customer’s account.<sup>36</sup> In contrast, the quantitative care obligation of Regulation Best Interest applies regardless of whether the Broker-Dealer exercises actual or *de facto* control over the customer’s account.<sup>37</sup> In the Regulation Best Interest Adopting Release, the Commission stated:

[I]mposing the quantitative care obligation without a “control” element would provide consistency in the investor protections provided to retail customers by requiring a broker-dealer to always form a reasonable basis as to the recommended frequency of trading in a retail customer’s account—irrespective of whether the broker-dealer “controls” or exercises “*de facto* control” over the retail customer’s account. This would also be consistent with the other obligations of the Care Obligation, which apply regardless of whether a broker-dealer “controls” or exercises “*de facto* control” over the retail customers’ account.<sup>38</sup>

The MSRB offered the same rationale eliminating the control element of the quantitative suitability obligation prescribed in Supplementary Material .05(c) of MSRB Rule G–19.<sup>39</sup>

ii. MSRB Rule G–48

MSRB Rule G–48(c) provides that a Dealer making a municipal securities recommendation to an SMMP does not have any obligation under MSRB Rule

<sup>34</sup> Regulation Best Interest defines a retail customer as a natural person, or the legal representative of such natural person, who receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer and uses the recommendation primarily for personal, family, or household purposes. See 17 CFR 240.15–1(b)(1).

<sup>35</sup> As noted above, the MSRB plans to issue a Request for Comment on whether the MSRB will apply the requirements of Regulation Best Interest to Bank Dealers through further amendments to MSRB rules. See Notice, 85 FR at 28083 n.5.

<sup>36</sup> MSRB Rule G–19, Supplementary Material .05(c).

<sup>37</sup> See 17 CFR 240.15–1(a)(2)(ii)(C); see also Regulation Best Interest Adopting Release, 84 FR at 33327.

<sup>38</sup> Regulation Best Interest Adopting Release, 84 FR at 33384 (citation omitted).

<sup>39</sup> See Notice, 85 FR at 28084.

G–19 to perform a customer-specific suitability analysis.<sup>40</sup> Under MSRB Rule D–15, an SMMP is defined by three components:

1. The customer must fit within a prescribed category of institutional investor or be a natural person or entity with total assets of at least \$50 million;<sup>41</sup>
2. The dealer must have a reasonable basis to believe that the customer is capable of evaluating investment risks and market value independently;<sup>42</sup> and
3. The customer must make certain affirmations regarding the exercise of independent judgment and access to information.<sup>43</sup>

As provided in MSRB Rule G–48(c), a Dealer making a recommendation to a natural person with at least \$50 million in assets and who otherwise meets the definition of SMMP, shall not have an obligation under MSRB Rule G–19 to perform a customer-specific suitability analysis.<sup>44</sup>

Though as discussed above in Section II(B)(i)(a), the proposed rule change would exclude the recommendations of Broker-Dealers to retail customers from the scope of MSRB Rule G–19, the MSRB also proposes to amend MSRB Rule G–48(c) to make clear that the exception contained therein from the obligation to conduct a customer-specific suitability analysis only applies when a recommendation is subject to MSRB Rule G–19 and not Regulation Best Interest.<sup>45</sup> As the MSRB stated in its Notice, there is no exception from the customer-specific care obligation for high-net worth individuals.<sup>46</sup>

C. Non-Cash Compensation

MSRB Rule G–20(g) broadly prohibits Dealers and their associated persons from directly or indirectly accepting or making payments or offers of payments of any non-cash compensation in connection with the sale and distribution of a primary offering of municipal securities, subject to certain limited exceptions.<sup>47</sup> The MSRB stated that described generally, these exceptions are:

1. Gifts that do not exceed \$100 per individual per year and are not preconditioned on achievement of a sales target;<sup>48</sup>
2. Occasional gifts of meals or tickets to theatrical, sporting, and other entertainments, provided that such gifts are

<sup>40</sup> *Id.*

<sup>41</sup> MSRB Rule D–15(a).

<sup>42</sup> MSRB Rule D–15(b).

<sup>43</sup> MSRB Rule D–15(c).

<sup>44</sup> See Notice, 85 FR at 28085.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> MSRB Rule G–20(d)(i).

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> 17 CFR 240.15–1(a)(1).

<sup>31</sup> See Notice, 85 FR at 28084.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

not so frequent or so extensive as to raise any question of propriety and are not preconditioned on achievement of a sales target;<sup>49</sup>

3. Payment or reimbursement by offerors (generally, the issuer and any advisors to the issuer, the underwriters, and their affiliates) in connection with training or education meetings, subject to specified conditions, including that the payment is not conditioned on achieving a sales target;<sup>50</sup>

4. Internal non-cash compensation arrangements between the dealer and its associated persons, subject to specified conditions including that any non-cash compensation related to a sales contest must be based on the total production of all associated persons with respect to all municipal securities within respective product types distributed by the dealer and credit for those sales must be weighted equally;<sup>51</sup> and

5. Contributions by any person other than the dealer to a non-cash compensation arrangement between a dealer and its associated persons, subject to the same conditions for permissible internal non-cash compensation arrangements, described above.<sup>52</sup>

Regulation Best Interest's Conflict of Interest Obligation requires, among other things, Broker-Dealers to establish, maintain and enforce written policies and procedures reasonably designed to, among other things, identify and eliminate sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time.<sup>53</sup> As described above, MSRB Rule G-20 permits certain sales contests in connection with primary offerings.<sup>54</sup> The proposed rule change clarifies that any non-cash compensation permitted by MSRB Rule G-20(g), including any

sales contests, must also be consistent with the applicable requirements of Regulation Best Interest.<sup>55</sup>

Additionally, in June 1982, the MSRB published interpretive guidance under MSRB Rule G-20 stating that sales contests offered by an underwriter to participating members of a syndicate constitute compensation for services and, therefore, must meet the requirements of the then-current version of MSRB Rule G-20.<sup>56</sup> The proposed rule change deletes the 1982 Guidance.<sup>57</sup> The MSRB noted that, depending on the particular facts and circumstances, such sales contests, with respect to Dealers that make recommendations to retail customers, may be inconsistent with the requirements of Regulation Best Interest's Conflict of Interest Obligation, which requires Broker-Dealers to establish, maintain and enforce written policies and procedures reasonably designed to "[i]dentify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time."<sup>58</sup> In support of its decision to rescind the 1982 Guidance, the MSRB quoted the following from the Commission's Adopting Release for Regulation Best Interest:

[s]ales contests, sales quotas, bonuses and non-cash compensation that are based on the sales of specific securities within a limited period of time create high-pressure situations for associated persons to increase the sales of specific securities or specific types of securities within a limited period of time and thus compromise the best interests of their retail customers.<sup>59</sup>

Deciding to rescind the 1982 Guidance for all recommendations of municipal securities transactions made by Dealers to all customers, the MSRB stated that the same policy concerns apply with respect to non-retail customers.<sup>60</sup> Specifically, the MSRB stated that the high-pressure sales situations described above have the potential to compromise the best interests of non-retail customers as well. Accordingly, the proposed rule change deletes this interpretation in full.<sup>61</sup>

<sup>55</sup> *Id.*

<sup>56</sup> See Rule G-20 Interpretive Guidance, "Authorization of Sales Contests" (June 25, 1982) ("1982 Guidance").

<sup>57</sup> See Notice, 85 FR at 28085.

<sup>58</sup> See 17 CFR 240.151-1(a)(2)(iii).

<sup>59</sup> Regulation Best Interest Adopting Release, 84 FR at 33331.

<sup>60</sup> See Notice, 85 FR at 28085.

<sup>61</sup> *Id.*

#### D. Books and Records

##### i. MSRB Rule G-8

MSRB Rule G-8 directs Dealers to make and keep current specified books and records to the extent they are applicable to a Dealer's business.<sup>62</sup> For Dealers subject to Exchange Act Rule 17a-3, MSRB Rule G-8(f) provides that compliance with Exchange Act Rule 17a-3 will be deemed compliance with MSRB Rule G-8, provided that certain records required by MSRB Rule G-8 must be maintained in any event. Exchange Act Rule 17a-3 requires Broker-Dealers to make and keep current specified books and records and provides that for purposes of transactions in municipal securities by Dealers, compliance with MSRB Rule G-8 will be deemed compliance with Exchange Act Rule 17a-3.<sup>63</sup>

When the Commission adopted Regulation Best Interest, it amended Exchange Act Rule 17a-3 to require Broker-Dealers to maintain a record of all information collected from and provided to a retail customer pursuant to Regulation Best Interest, along with the identity of each natural person who is an associated person, if any, responsible for the account.<sup>64</sup> The Commission also adopted a related requirement for Broker-Dealers to provide retail investors with Form CRS<sup>65</sup> and amended Exchange Act Rule 17a-3 to require Broker-Dealers to maintain a record of the date it provided each Form CRS to its retail customers.<sup>66</sup>

The MSRB stated that the proposed rule change includes amendments to MSRB Rule G-8 that parallel the new Exchange Act Rule 17a-3 requirements relating to Regulation Best Interest and Form CRS because Broker-Dealers may comply with Exchange Act Rule 17a-3 for purposes of transactions in municipal securities by complying with MSRB Rule G-8.<sup>67</sup> Specifically, the proposed rule change requires that each Broker-Dealer shall make and keep current in its books and records: (i) Under proposed MSRB Rule G-8(a)(xi)(F), a record of all information collected from, and provided to, a retail customer (as well as the identity of each natural person who is an associated person, if any, responsible for the account), to whom a recommendation of any securities transaction or investment strategy involving municipal securities is or will be provided; and (ii) under

<sup>62</sup> See Notice, 85 FR at 28085-8.

<sup>63</sup> 17 CFR 240.17a-3.

<sup>64</sup> 17 CFR 240.17a-3(a)(35).

<sup>65</sup> 17 CFR 240.17a-14.

<sup>66</sup> 17 CFR 240.17a-3(a)(24).

<sup>67</sup> See Notice, 85 FR at 28086.

<sup>49</sup> MSRB Rule G-20(d)(ii).

<sup>50</sup> MSRB Rule G-20(d)(iii).

<sup>51</sup> MSRB Rule G-20(d)(iv).

<sup>52</sup> MSRB Rule G-20(d)(v).

<sup>53</sup> 17 CFR 240.151-1(a)(2)(iii)(D). The Conflict of Interest Obligation also requires broker-dealers to (1) identify and at a minimum disclose or eliminate all conflicts of interest associated with a recommendation of any securities transaction or investment strategy involving securities to a retail customer; (2) identify and mitigate any conflicts of interest associated with such recommendations that create an incentive for a natural person who is an associated person of a broker-dealer to place the interest of the broker-dealer or such natural person ahead of the interest of the retail customer; and (3) 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 and prevent such limitations and associated conflicts of interest from causing the broker-dealer, or a natural person who is an associated person of the broker-dealer, to make recommendations that place the interest of the broker-dealer or such natural person ahead of the interest of the retail customer. 17 CFR 240.151-1(a)(3)(A)-(C).

<sup>54</sup> See Notice, 85 FR at 28085.

proposed MSRB Rule G–8(a)(xxvii), a record of the date that each Form CRS was provided to each retail investor (including any Form CRS before any such retail investor opens an account).<sup>68</sup> The MSRB stated it believes that the proposed rule change’s amendments are necessary to ensure that Broker-Dealers subject to Regulation Best Interest and the Form CRS requirement are required to maintain the records regardless of which books and records rule they follow.<sup>69</sup>

ii. MSRB Rule G–9

MSRB Rule G–9 prescribes the periods of time that records must be preserved by Dealers.<sup>70</sup> Similar to MSRB Rule G–8, MSRB Rule G–9 provides that Dealers who are subject to and comply with Exchange Act Rules 17a–3 and 17a–4 will be deemed to comply with MSRB Rule G–9, provided that certain specified records are preserved for the applicable time periods specified in Rule G–9 in any event.<sup>71</sup> Exchange Act Rule 17a–4 establishes record preservation requirements for Broker-Dealers and, like Exchange Act Rule 17a–3, provides that for purposes of transactions in municipal securities by Dealers, compliance with MSRB Rule G–9 will be deemed compliance with Exchange Act Rule 17a–4.<sup>72</sup>

The Commission amended Exchange Act Rule 17a–4 to require Broker-Dealers to retain the records related to Regulation Best Interest and Form CRS described above for six years.<sup>73</sup> The MSRB stated that the proposed rule change includes amendments to MSRB Rule G–9 to parallel these new requirements.<sup>74</sup> Specifically, this proposed rule change requires preserving copies of: (i) All documents required under MSRB Rule G–8(a)(xi)(F) (until at least six years after the earlier of the date the account was closed or the date on which the information was collected, provided, replaced, or updated); and (ii) the records concerning Form CRS (required to be maintained pursuant to Rule G–8(a)(xxvii)); and (iii) a copy of each Form CRS, until at least six years after such record or Form CRS is created.<sup>75</sup> The MSRB stated that the proposed rule change’s revisions to MSRB G–9 are necessary to ensure that Broker-Dealers are subject to similar requirements,

whether under MSRB rules or the rules of the SEC.<sup>76</sup>

### III. Discussion and Commission Findings

The Commission has carefully considered the proposed rule change and the comment letters received. 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:

[B]e 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.<sup>77</sup>

#### A. Amendments Related to Suitability

The Commission finds that the proposed rule change’s proposed amendments to MSRB Rules G–19 and G–48 are consistent with Exchange Act Section 15B(b)(2)(C) because the amendments will foster cooperation and coordination with regulators, facilitate transactions in municipal securities and municipal financial products, remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and protect investors.<sup>78</sup>

#### i. Eliminating the Applicability of MSRB Rule G–19 to Recommendations Subject to Regulation Best Interest

The Commission believes that the proposed rule change’s revision to MSRB Rule G–19 will protect investors by ensuring Broker-Dealers comply with the heightened regulatory requirements of the Commission’s Regulation Best Interest. As stated by the Commission in the Regulation Best Interest Adopting Release:

The enhancements contained in Regulation Best Interest are designed to improve investor protection by enhancing the quality of broker-dealer recommendations to retail

customers and reducing the potential harm to retail customers that may be caused by conflicts of interest.<sup>79</sup>

The Commission also finds that the proposed rule change’s revisions to MSRB Rule G–19 to eliminate the applicability of MSRB Rule G–19’s suitability requirements to recommendations subject to Regulation Best Interest will foster cooperation and coordination with regulators by harmonizing MSRB rules with Regulation Best Interest. The Commission also believes that the proposed rule change will facilitate transactions in municipal securities and municipal financial products and remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products by eliminating potential regulatory duplication and complexity through the establishment of a uniform standard for assessing the recommendations of municipal securities made by Broker-Dealers to retail customers.

#### ii. Aligning MSRB Rule G–19’s Quantitative Suitability Obligation to the Requirements of Regulation Best Interest

The Commission finds that proposed rule change’s amendments to MSRB Rule G–19 eliminating the control element from a Dealer’s quantitative suitability obligations for recommendations subject to MSRB Rule G–19 will enhance investor protection for customers that are not retail customers for purposes of Regulation Best Interest by requiring a Dealer to always form a reasonable basis as to the recommended frequency of trading in a retail customer’s account—irrespective of whether the Dealer “controls” or exercises “*de facto* control” over the retail customer’s account.<sup>80</sup>

The Commission also believes that the proposed rule change will foster cooperation and coordination with regulators by joining the Commission (in Regulation Best Interest) and FINRA (in FINRA–2020–07)<sup>81</sup> in collectively eliminating the control element from assessing the recommendations made by Dealers. In this respect, the proposed rule change will allow Dealers to more efficiently operationalize compliance with their obligations under both Regulation Best Interest and MSRB Rule G–19, and to more efficiently

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> 17 CFR 240.17a–4(e)(5), (e)(10).

<sup>74</sup> See Notice, 85 FR at 28086.

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> 15 U.S.C. 78o–4(b)(2)(C).

<sup>78</sup> *Id.*

<sup>79</sup> Regulation Best Interest Adopting Release, 83 FR at 33321.

<sup>80</sup> See, e.g., Regulation Best Interest Adopting Release, 83 FR at 33374.

<sup>81</sup> See Exchange Act Release No. 89091 (June 18, 2020), 85 FR 37970 (June 23, 2020) (SR–FINRA–2020–07).

recommend and ultimately execute transactions in the municipal securities market without any attendant reduction in investor protection and thereby facilitate transactions in municipal securities and municipal financial products and remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products.

iii. Amending MSRB Rule G-48(c) To State That the Exception From the Customer-Specific Suitability Requirement Is Available Only When a Recommendation Is Subject To MSRB Rule G-19

The Commission believes that the proposed rule change's revision of MSRB Rule G-48(c) (stating that the exception from the customer-specific suitability requirement is available only when a recommendation is subject to MSRB Rule G-19) will foster cooperation and coordination with regulators by harmonizing MSRB rules with Regulation Best Interest and enhance investor protection by ensuring that the Best Interest Standard applies to all recommendations by Broker-Dealers made to retail customers irrespective of their net worth. By clarifying that there is no SMMP-based exception to a Broker-Dealer's obligations when making a recommendation to a retail customer, all retail customers of Broker-Dealers will benefit from the enhanced quality of Broker-Dealer recommendations and reduced harm caused by conflicts of interest, consistent with Regulation Best Interest.

The Commission also believes that eliminating any ambiguity regarding the interplay of MSRB Rule G-48 and MSRB Rule G-19 will enable Broker-Dealers to more efficiently fulfill their regulatory obligations and thereby remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products market due to the greater regulatory certainty under the proposed rule change.

*B. Amendments Related to Non-Cash Compensation*

The Commission believes that the approach proposed by the MSRB with respect to its non-cash compensation rules is appropriate and designed to protect investors and the public interest, consistent with of the Exchange Act. In particular, the Commission believes that the proposed rule change will help protect investors and the public interest by clarifying that the incentives Dealers may offer pursuant to non-cash compensation arrangements under the relevant MSRB rules as amended are

consistent with the applicable requirements under Regulation Best Interest. For these reasons, the Commission finds that the proposed rule change to MSRB Rule G-20 is consistent with the Exchange Act.

Furthermore, by clarifying that any non-cash compensation permitted by MSRB Rule G-20(g) must also be consistent with the applicable requirements of Regulation Best Interest to be permissible and thereby eliminating any potential regulatory duplication or ambiguity, the Commission believes that the proposed rule change will foster cooperation and coordination with regulators as well as remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products by harmonizing MSRB rules with Regulation Best Interest.<sup>82</sup>

*C. Amendments Related to Books and Records*

The Commission believes that the proposed rule change's amendments to MSRB Rules G-8 and G-9 are consistent with Exchange Act Section 15B(b)(2)(C) because the proposed rule change will foster cooperation and coordination with regulators, facilitate transactions in municipal securities and municipal financial products, remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and protect investors.<sup>83</sup>

i. Amending MSRB Rule G-8 To Align With Exchange Act Rule 17a-3

The Commission believes that the proposed rule change to MSRB Rule G-8 will foster cooperation and coordination with regulators and will protect investors by harmonizing MSRB rules with the Commission's record-keeping requirements under Exchange Act Rule 17a-3, as amended by Regulation Best Interest and Form CRS. Specifically, the Commission believes that the proposed rule change will enable regulators to assess Broker-Dealers' compliance with their obligations under Regulation Best Interest and Form CRS by ensuring that such Broker-Dealers are required to make records related to Regulation Best Interest and Form CRS regardless of whether they look to MSRB Rule G-8 or Exchange Act Rule 17a-3 for their record-making obligations. The Commission also believes that this approach to ensuring Broker-Dealer compliance with the requirements of

Regulation Best Interest and Form CRS will also protect investors by ensuring that Broker-Dealers, whether they follow MSRB G-8 or Exchange Act Rule 17a-3, will be obligated to create certain records to evidence their compliance with their obligations.

ii. Amending MSRB Rule G-9 To Align With Exchange Act Rule 17a-4

The Commission finds that the proposed rule change's revisions to MSRB Rule G-9 to correspond with SEC books and records requirements will protect investors, thereby ensuring that Broker-Dealers are subject to similar requirements, whether under MSRB rules or the rules of the SEC under record-keeping requirements under Exchange Act Rule 17a-4, as amended by Regulation Best Interest and Form CRS. Specifically, the Commission believes that the proposed rule change will enable regulators to assess Broker-Dealers' compliance with their obligations under Regulation Best Interest and Form CRS by ensuring that such Broker-Dealers are required to preserve records related to Regulation Best Interest and Form CRS regardless of whether they look to MSRB Rule G-9 or Exchange Act Rule 17a-4 for their record-making obligations. The Commission also believes that this approach to ensuring Broker-Dealer compliance with the requirements of Regulation Best Interest and Form CRS will also protect investors by ensuring that Broker-Dealers, whether they follow MSRB G-9 or Exchange Act Rule 17a-4, will be obligated to preserve certain records to evidence their compliance with their obligations for the same duration.

In approving the proposed rule change, the Commission has considered the proposed rule change's impact on efficiency, competition, and capital formation.<sup>84</sup> Exchange Act Section 15B(b)(2)(C)<sup>85</sup> 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 rule change 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 (or otherwise clarify the applicability of MSRB rules in relation to) the requirements of Regulation Best Interest.

Moreover, the Commission observes that because Bank Dealers are not

<sup>82</sup> 15 U.S.C. 78o-4(b)(2)(C).

<sup>83</sup> *Id.*

<sup>84</sup> 15 U.S.C. 78c(f).

<sup>85</sup> 15 U.S.C. 78o-4(b)(2)(C).

subject to Regulation Best Interest or Form CRS, any different compliance standards between Bank Dealers and non-Bank Dealers under MSRB Rules result from Regulation Best Interest and Form CRS directly rather than the MSRB's promulgation of rules for consistency therewith. Consequently, this proposed rule change will not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, because it does not change the already existing competitive landscape between Broker-Dealers subject to Regulation Best Interest and Form CRS and Bank Dealers not subject thereto. In addition, to the extent the proposed rule change imposes regulatory obligations in excess of those prescribed by Regulation Best Interest or Form CRS, those new obligations apply equally to all Dealers, and therefore does 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. Furthermore, the Commission believes the proposed rule change would not impose barriers to capital formation, as the intention is to increase regulatory certainty by harmonizing MSRB rules with Regulation Best Interest. The Commission also finds that the proposed rule change includes provisions that help promote efficiency. In particular, the Commission believes the proposed rule change may improve Dealers' regulatory certainty by promoting clarity and consistency on issues related to suitability and permissible non-cash compensation, as well recordkeeping and record-making.

The Commission received comment letters on the proposed rule change, which were supportive of the proposed rule change and suggested no amendments to the proposed rule change.<sup>86</sup>

For the reasons noted above, the Commission believes that the proposed rule change is consistent with the Exchange Act.

<sup>86</sup> See Letter to Secretary, Commission, from Kelli McMorrow, Head of Government Affairs & Director of Fixed Income Policy, American Securities Association, dated May 21, 2020 (the "ASA Letter"); Letter to Secretary, Commission, from Kristen Malinconico, Director, U.S. Chamber of Commerce's Center for Capital Market Competitiveness, dated June 2, 2020 (the "CCMC Letter").

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Exchange Act,<sup>87</sup> that the proposed rule change (SR-MSRB-2020-02) be, and hereby is, approved.

For the Commission, pursuant to delegated authority.<sup>88</sup>

**J. Matthew DeLesDernier,**

*Assistant Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-89153; File No. SR-Phlx-2020-30]

#### Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Options 9, Section 13 To Increase the Position Limits for Options on Certain Exchange-Traded Funds

June 25, 2020.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 17, 2020, Nasdaq PHLX LLC ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of the Substance of the Proposed Rule Change

The Exchange proposes to amend Options 9, Section 13, Position Limits, to increase position limits for options on certain exchange-traded funds ("ETFs"). The Exchange is also proposing to amend Options 4A, Section 10, Limitation of Exchange Liability, to replace this rule with rule text that was inadvertently deleted in a prior rule change.

The text of the proposed rule change is available on the Exchange's website at <http://nasdaqphlx.cchwallstreet.com/>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

<sup>87</sup> 15 U.S.C. 78s(b)(2).

<sup>88</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

#### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

##### 1. Purpose

The Exchange proposes to amend Options 9, Section 13, Position Limits, to increase position limits for options on certain exchange-traded funds ("ETFs"). These proposed rule changes are based on the similar proposal by Cboe Exchange, Inc. ("Cboe").<sup>3</sup> The Exchange proposes to make certain minor non-substantive technical corrections to certain ETF names and symbols within Options 9, Section 13. The Exchange is also proposing to amend Options 4A, Section 10, Limitation of Exchange Liability, to replace this rule with rule text that was inadvertently deleted in a prior rule change. Each change will be described below.

Position limits are designed to address potential manipulative schemes and adverse market impacts surrounding the use of options, such as disrupting the market in the security underlying the options. While position limits should address and discourage the potential for manipulative schemes and adverse market impact, if such limits are set too low, participation in the options market may be discouraged. The Exchange believes that position limits must therefore be balanced between mitigating concerns of any potential manipulation and the cost of inhibiting potential hedging activity that

<sup>3</sup> See Securities Exchange Act Release No. 88768 (April 29, 2020) (SR-CBOE-2020-015) (Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Increase Position Limits for Options on Certain Exchange-Traded Funds and Indexes). The Cboe proposal also proposed to increase position limits for options overlying the MSCI Emerging Markets Index ("MXEF") and the MSCI EAFE Index ("MXEA"). The Exchange, however, does not list options on the MXEF or MXEA indexes. Accordingly, this proposal is limited to the ETFs described above.