MSRB
Municipal Securities Rulemaking Board

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Request for Comment on Draft MSRB Rule G-36, on Discretionary Transactions in Customer Accounts, and Related Draft Amendments

Overview

The Municipal Securities Rulemaking Board (MSRB) is requesting comment on draft MSRB Rule G-36, on discretionary transactions in customer accounts, and related draft amendments. Draft Rule G-36 would re-establish a standalone rule to govern discretionary transactions by brokers, dealers and municipal securities dealers (collectively, "dealers") and their associated persons in customer accounts by consolidating and explicitly articulating existing requirements for such transactions. Additionally, draft Rule G-36 would establish limited, new requirements for discretionary transactions in customer accounts effected by individuals other than dealers and their associated persons. The MSRB is considering these rule changes to provide clarity to all dealers, securities firms and banks, on their obligations related to discretionary transactions in customer accounts, to improve consistency with similar rules of other regulators and to fulfill its previously-stated intention to address these types of transactions in a separate rule. The MSRB believes this potential rulemaking is consistent with its current strategic goal to assist dealers and other regulated entities with compliance with MSRB rules, as it would streamline, and bring consistency and uniformity to, the rules relating to discretionary transactions in customer accounts, which the MSRB believes would, in turn, assist dealers and their associated persons in complying with these requirements and improve regulatory efficiency, while imposing a relatively small burden on them to achieve compliance.

Comments should be submitted no later than July 16, 2018 and may be submitted in electronic or paper form. Comments may be submitted electronically by clicking here. Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities

Rulemaking Board, 1300 I Street NW, Suite 1000, Washington, DC 20005. All comments will be available for public inspection on the MSRB's website.[1]

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

Background

Until 1985, the MSRB had a standalone rule, former MSRB Rule G-26,[2] that governed the administration of discretionary and other accounts.[3] Former Rule G-26 had three requirements:

(1) at or before the completion of a transaction in municipal securities with or for the account of a customer, a dealer had to obtain customer account information required by MSRB Rule G-8(a)(xi);[4]

(2) no dealer could effect a transaction in municipal securities with or for a discretionary account without prior written authorization of the customer accepted in writing by a municipal securities principal or municipal securities sales principal (collectively, "principal") on behalf of the dealer; and

[1] Comments generally are posted on the MSRB's website without change. For example, personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.

[2] MSRB Rule number G-26 has since been assigned to the rule governing customer account transfers.

[3] MSRB Rule D-10 defines "discretionary account" as "the account of a customer carried or introduced by a [dealer] with respect to which such [dealer] is authorized to determine what municipal securities will be purchased, sold or exchanged by or for the account." A discretionary account will not be deemed to exist if the professional's discretion is limited to the price or time at which an order given by a customer for a definite amount of a specified security is executed. *See* Notice of Approval of Fair Practice Rules, [1977-1987 Transfer Binder] Municipal Securities Rulemaking Board Manual (CCH) ¶10,090, at 10,495 (Oct. 24, 1978), *available at* http://msrb.org/Rules-and-Interpretations/MSRB-Rules/Definitional/Rule-D-10.aspx?tab=2.

[4] At the time, Rule G-8(a)(xi)(I) required dealers to make and keep current records, including, with respect to discretionary accounts, the customer's written authorization to exercise discretionary power or authority with respect to the account, written approval of the municipal securities principal who supervised the account and written approval of the municipal securities principal with respect to each transaction in the account, indicating the time and date of approval. *See* Securities and Exchange Act of 1934 ("Exchange Act") Release No. 14053 (Oct. 14, 1977), 42 FR 56550 (Oct. 26, 1977) (SR-MSRB-77-5).

(3) a principal promptly had to review and approve in writing each transaction in municipal securities effected with or for a discretionary account introduced or carried by the dealer, as well as review at regular and frequent intervals all such accounts in order to detect and prevent irregularities and abuses.

In 1985, the MSRB deleted former Rule G-26 from the rulebook and reorganized the first two requirements of the rule into MSRB Rule G-19, on suitability of recommendations and transactions, and the third requirement into MSRB Rule G-27, on supervision.[5] The purpose of the reorganization was to have all suitability-related requirements and supervision-related requirements, including those related to discretionary accounts, contained in dedicated topical rules.[6] Rule G-19 already included provisions related to transactions in discretionary accounts that prohibited churning in those accounts (*i.e.*, transactions that are excessive in size or frequency in view of information known to the dealer, concerning the customer's financial background, tax status and investment objectives) and that required a dealer to first determine that a transaction was suitable for the customer based upon information available from the customer, unless the transaction was specifically authorized by the customer.[7] For almost 30 years thereafter, the provisions related to transactions in discretionary accounts in Rule G-19, Rule G-27 and other MSRB rules remained in place with limited changes.[8]
In 2014, the MSRB amended Rule G-19 to more closely harmonize with the corresponding suitability rule of the Financial Industry Regulatory Authority (FINRA).[9] As a part of this rulemaking, the MSRB noted that the suitability obligation is the same for discretionary and non-discretionary accounts, so there was no reason to restate the obligation as it specifically related to discretionary accounts.[10] Further, the MSRB stated its belief that it would be more appropriate for the non-suitability-related provisions on discretionary accounts contained in Rule G-19 to be set forth in a separate rule devoted to

[5] *See* Exchange Act Release No. 21990 (Apr. 25, 1985), 50 FR 18602 (May 1, 1985) (SR-MSRB-85-6).
[6] *See* Exchange Act Release No. 21819 (Mar. 6, 1985), 50 FR 9932 (Mar. 12, 1985) (SR-MSRB-85-6).
[7] *Id.*
[8] *See* Exchange Act Release Nos. 25021 (Oct. 14, 1987), 52 FR 39320 (Oct. 21, 1987) (SR-MSRB-87-9); 35846 (June 14, 1995), 60 FR 32186 (June 20, 1995) (SR-MSRB-95-9).
[9] *See* Exchange Act Release Nos. 70593 (Oct. 1, 2013), 78 FR 62867 (Oct. 22, 2013) (SR-MSRB-2013-07); 71665 (Mar. 7, 2014), 79 FR 14321 (Mar. 13, 2014) (SR-MSRB-2013-07). *See also* FINRA Rule 2111.
[10] *See* Exchange Act Release No. 70593 (Oct. 1, 2013), 78 FR 62867 (Oct. 22, 2013) (SR-MSRB-2013-07).

the subject.[11] In light of this, and the facts that the discretionary account provisions in Rule G-19 were substantially similar to the requirements of Rule G-8(a)(xi)(I)[12] and that dealers continued to owe their customers a duty of fair dealing under MSRB Rule G-17, the MSRB deleted the provisions on discretionary accounts from the rule and indicated that it would address discretionary accounts in a separate rule at a future date.[13]

Draft Amendments to Rule G-36

The primary purpose of draft Rule G-36[14] would be to re-establish a standalone rule to govern transactions in discretionary accounts, which the MSRB committed to doing in the context of previous rulemaking. The MSRB believes that re-establishing a substantive rule directly addressing the issues, and consolidating and articulating affirmative requirements, rather than primarily relying on implicit requirements in a books-and-records rule would provide dealers clarity as to their obligations for such accounts and would better harmonize MSRB rules with similar rules of other regulators, thus improving consistency and uniformity of rules relating to discretionary transactions in customer accounts. The MSRB believes this clarity and harmonization would, in turn, assist dealers and their associated persons in complying with the requirements for such transactions and improve regulatory efficiency. Finally, the MSRB believes that draft Rule G-36 would enhance investor protection by assisting regulators in identifying possible trading or sales practice violations, such as churning, trading ahead of customers, front-running, unauthorized trading and possible manipulative activities involving discretionary accounts and other discretionary transactions in customer accounts.

The MSRB also believes there would be benefits to addressing the use of discretion for transactions in customer accounts more comprehensively, including when discretion is granted to a third-party agent of the customer, who is not an associated person of the dealer ("non-dealer agent"). Specifically, the MSRB believes it is important to expand the scope of the rulemaking to address these scenarios to recognize current practices in the municipal market and to provide investors with basic protections from unauthorized trading in their customer accounts.

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[11] *See* MSRB Notice 2013-07 (Mar. 11, 2013).

[12] Rule G-8(a)(xi)(I) currently requires dealers to make and keep current the following books and records with respect to discretionary accounts: (1) the customer's written authorization to exercise discretionary power or authority with respect to the account, (2) written approval of a principal who supervises the account, and (3) written approval of a principal with respect to each transaction in the account, indicating the time and date of approval.

[13] *See* notes 9 and 11 *supra*.

[14] Rule number G-36 currently is reserved.

Lastly, the MSRB believes minor amendments to other rules relating to discretionary accounts would be required to facilitate draft Rule G-36 and its varied requirements.

Transactions in Discretionary Accounts

As noted above, under Rule D-10, a "discretionary account" is a customer account in which the dealer is authorized to determine what municipal securities will be bought, sold or exchanged by or for the account. Draft Rule G-36 would include provisions that are substantially similar to previous MSRB requirements related to transactions in discretionary accounts, and/or are captured by existing MSRB rules, to address this type of account structure when the discretion is granted to the dealer. First, one former provision specifically prohibited dealers from effecting transactions in discretionary accounts unless the customer had provided clear permission by a prior written authorization, which was accepted by a principal on behalf of the dealer.[15] Under draft Rule G-36(a)(i), the same authorization and account acceptance would be required, but the language would be more specific in detailing the process by clarifying that the customer must sign and date the written authorization to be provided to a named associated person or associated persons,[16] requiring that the principal denote that the account has been accepted in accordance with the dealer's policies and procedures for acceptance of discretionary accounts,[17] and limiting the discretion to the scope of the prior written authorization.[18] Draft Rule G-36(a)(iii) would clarify that the person with whom discretionary power is vested in the customer's

[15] *See* former Rule G-19(d)(i).

[16] The signature and date requirements generally would be consistent with Exchange Act Rule 17a-3(a)(17)(ii), which requires that, for each discretionary account with a natural person, dealers maintain a record containing the dated signature of the customer granting authorization.

[17] Rule G-8(a)(xi)(H) already requires dealers to make and keep a record for each customer, other than an institutional account, that includes, among other things, the signature of a principal, indicating acceptance of the account, and, therefore, dealers should already have policies and procedures that address this and other recordkeeping requirements. *See also* FINRA Rule 4512(a)(1)(C) (requiring that, for each account, dealers maintain the name(s) of the associated person(s), if any, responsible for the account); FINRA Rule 4512(a)(1)(D) (requiring that, for each account, dealers maintain the signature of the partner, officer or manager denoting that the account has been accepted in accordance with the dealer's policies and procedures for acceptance of accounts).

[18] This requirement would be a clarification of the existing authorization requirement implicit in Rule G-8(a)(xi)(I) and generally is consistent with FINRA Rule 2090 (Know Your Customer), which requires dealers to use reasonable diligence to understand the authority of each person acting on behalf of the customer.

account could not be the principal who accepts the account in order to avoid the conflict of interest and provide an added layer of customer protection. A second former MSRB provision prohibited churning or the recommendation of transactions that are excessive in size or frequency in view of information known to the dealer concerning the customer's financial background, tax status and investment objectives.[19] Although the MSRB several years ago recast the substance of the churning provision as a quantitative suitability obligation in paragraph .05(c) of the Supplementary Material to Rule G-19,[20] draft Rule G-36(a)(ii) would prohibit transactions in discretionary accounts that are excessive in size or frequency in view of the customer's investment profile[21] to ensure that the prohibition on churning applies to transactions for which there is no explicit recommendation due to the discretionary nature of the account.

In addition, draft Rule G-36(a)(iii) would require that every order entered in a discretionary account pursuant to the exercise of discretionary power by the dealer must be identified as discretionary on the order at the time of entry, and that a principal, other than the associated person vested with discretionary power in the discretionary account, must approve promptly in writing each trade entered in the account and to review such account at frequent intervals to detect and prevent transactions that are excessive in size or frequency in view of the customer's investment profile. The order-marking requirement already exists in Rule G-8(a)(vi),[22] and the approval requirement for transactions is implicitly captured by Rule G-8(a)(xi)(I), which requires the written approval of a principal for each transaction in the account, and Rule G-27(c)(i)(G)(2), which requires written supervisory

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[19] *See* former Rule G-19(e).

[20] *See* MSRB Notice 2014-07 (Mar. 12, 2014). Quantitative suitability 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, as delineated in Rule G-19. *See* paragraph .05(c) of the Supplementary Material to Rule G-19. No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a dealer has violated the quantitative suitability obligation. *Id.*

[21] "A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the [dealer] in connection with such recommendation." Rule G-19.

[22] *See also* Exchange Act Rule 17a-3(a)(6)(i) (requiring that an order entered pursuant to the exercise of discretionary authority by an associated person of a dealer be designated as such).

procedures for the prompt review and written approval by a principal of each transaction on a daily basis. The new provision would not prescribe how dealers perform the trade approvals, providing dealers with flexibility to determine the best approach for their business (*e.g.*, post trade and/or in bulk), so long as the approvals are done promptly and no less frequent than daily as permitted by Rule G-27. The requirement for frequent reviews to detect churning would be consistent with Rule G-27(c)(i)(C), which requires written supervisory procedures for the regular and frequent review and approval by a designated principal of customer accounts. Including this provision, the authorization and account acceptance requirements, and the prohibition on churning in draft Rule G-36 would closely harmonize the rule with similar rules of the Securities and Exchange Commission (SEC) and other self-regulatory organizations (SROs).[23]

Transactions by Non-Dealer Agents of Customers

The potential to exercise discretion in customer accounts is not limited to dealers and their associated persons, and draft Rule G-36(b) would address situations in which customers authorize non-dealer agents to effect transactions in their accounts held at dealers. This provision of the new rule would address the situations where any individual or entity, who is not the dealer or an associated person thereof, is authorized to effect transactions in a customer account held at the dealer. These would include, but not be limited to, an investment adviser engaged in investment adviser discretionary activities and any person granted non-investment adviser discretionary authority, such as a family member. More specifically, draft Rule G-36(b) only would apply to those circumstances where the order is from a non-dealer agent who is not the customer (*i.e.*, the accountholder), and it would not require a dealer or an associated person to look through an intermediary (*e.g.*, an investment adviser) to the underlying beneficial owners where the intermediary, and not the underlying beneficial owners, is identified as the dealer's customer.[24] Further, the requirements of draft Rule

[23] *See* Exchange Act Rule 15c1-7(a) (including churning in a discretionary account in the definition of a manipulative, deceptive, or other fraudulent device or contrivance under Section 15(c) of the Exchange Act); National Association of Securities Dealers (NASD) Rule 2510 (governing discretionary accounts); New York Stock Exchange (NYSE) Rule 408 (addressing discretionary power in customers' accounts). The NASD and NYSE rules are incorporated into the FINRA rulebook.

[24] For instance, where an investment adviser opens a master account, and associated subaccounts, at a dealer for trade execution purposes only and transactions are settled on a delivery-versus-payment basis to the investment adviser's clients' accounts at the clients' custodial financial institution, the investment adviser (rather than the investment adviser's clients) ordinarily would be considered the dealer's customer. *See* MSRB Notice 2016-29

G-36(b) would not extend to the situation where a customer is a legal entity that has authorized its personnel to place trades for the entity. The MSRB does not believe draft Rule G-36(b) would create an unnecessary burden with respect to a dealer's ability to identify its customers (*i.e.*, accountholders) and to obtain the required authorizations. Neither former Rule G-26 nor former Rule G-19 included provisions to address this type of discretion by non-dealer agents in customer accounts; however, the MSRB believes there is a need to provide customers this protection from unauthorized trading in their accounts.[25] Additionally, addressing this type of discretion in customer accounts would harmonize with NYSE Rule 408, which prohibits a dealer from accepting orders for an account from a person other than the customer without first obtaining the customer's written authorization, the signature of the person or persons authorized to exercise discretion in the account, and the date such discretionary authority was granted.

Specifically, draft Rule G-36(b) would require dealers to obtain authorization for and acceptance of the account in the same fashion it would for a discretionary account by requiring that, before accepting an order for a customer's account from any person other than the customer, dealers and associated persons must obtain the customer's signed and dated prior written authorization granting discretionary power to such person, and that the order placed by that person be within the scope of that person's authority as specified in the customer's authorization. Draft Rule G-36(b) also would prescribe that, where the customer provides such authorization to a natural person, a dealer or associated person must obtain the prior dated signature of the named person, and, where the customer provides such authorization to an entity, a dealer or associated person must obtain the prior dated signature of a natural person authorized to act on behalf of the entity[26] and make reasonable efforts to obtain the names of all individuals authorized by the entity to act on behalf of the customer.

(Dec. 1, 2016); MSRB Notice 2003-20 (May 23, 2003); Interpretive Notice on Recordkeeping (Jul. 29, 1977).

[25] While the former rules were always limited in their applicability by the MSRB's definition of "discretionary account," which limits the discretion to dealers, in approving the deletion of former Rule G-26 and the relocation of certain of its provisions into Rule G-19, the SEC noted that there should not be an exception to the discretionary account requirements made for "investment management accounts" because customers with such accounts would benefit from the protection afforded by the rules. *See* note 5 *supra*.

[26] This initial authorization requirement would be a one-time requirement, and a dealer would not be required to obtain additional signatures if the original signor leaves or is no longer authorized.

The MSRB does not believe the prohibition on churning or the order-marking, transaction-approval and frequent account-review requirements should be applied for customer accounts in which a non-dealer agent has discretion. These accounts would include, but not be limited to, fee-based only accounts, such as accounts that are charged only a flat fee or a fee based on assets under management. Dealers do not have control over the transactions effected in such accounts and, therefore, should not be required to monitor the activity in such accounts as closely or beyond what is required for any other customer account under MSRB rules, so long as the transactions effected pursuant to the non-dealer agent's discretionary power are within the scope of the authorization provided to the dealer by the customer.[27] Additionally, the MSRB does not believe there is any significant incentive to churn a fee-based only account without transaction-based compensation, which eliminates or, at least, reduces the need for a prohibition of churning and approval of individual transactions for such accounts.

Electronic Signatures

To expedite and more easily allow investors to establish discretionary accounts or grant discretion to non-dealer agents, the authorization and approval requirements of draft Rule G-36 could be satisfied through the use of "electronic" means, pursuant to paragraph .01 of the Supplementary Material. Specifically, the MSRB would consider a valid electronic signature to be any electronic mark that clearly identifies the signatory and is otherwise, as applicable to the dealer, in compliance with the Electronic Signatures in Global and National Commerce Act of 2000 ("E-Sign Act")[28] and the guidance issued by the SEC relating to the E-Sign Act.[29]

Clarifying and Other Amendments

By re-establishing a standalone rule for transactions in discretionary accounts and adding provisions to address transactions by non-dealer agents with discretion in customer accounts, there would be a need to amend existing

[27] All of the requirements for discretionary accounts under draft Rule G-36(a) would apply to an associated person of a dealer: (1) who is engaged in investment adviser discretionary activities in a customer's account at the dealer; or (2) who is granted non-dealer and non-investment adviser discretionary authority (*e.g.*, by power of attorney) by a customer of the dealer, who is a family member of the associated person. The MSRB believes that such discretionary activities involve the placing of brokerage orders by an associated person of a dealer for a customer's account at the dealer, and such activities should be subject to the higher standard of review and approval.

[28] Pub. L. 106-229, 114 Stat. 464.

[29] Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media Under the Electronic Signatures in Global and National Commerce Act of 2000 with Respect to Rule 17a4-(f), Exchange Act Rel. No. 44238 (May 1, 2001), 66 FR 22916 (May 7, 2001).

rules as they relate to those account structures. The MSRB believes the following amendments would provide greater clarity to dealers as to what constitutes a discretionary account, and the requirements related to them and other uses of discretion in customer accounts as follows:

- Rule G-8: Books and Records to Be Made by Brokers, Dealers, and Municipal Securities Dealers and Municipal Advisors – The MSRB believes certain amendments should be made to Rule G-8(xi)(I) to conform the books-and-records requirements related to discretionary accounts to draft Rule G-36, including the addition of requirements for dealers to make and keep current records of the frequent reviews of discretionary accounts and the written authorizations for non-dealer agents to use discretion in customer accounts;

- Rule D-10: "Discretionary Account" – The MSRB believes Rule D-10 can be improved by codifying the interpretive guidance from the 1978 Rule D-10 rulemaking record that excludes from the definition accounts in which the dealer's discretion is limited to the price at which, or the time at which, an order given by a customer for a purchase or sale of a definite amount of a specified security is executed.[30]

Economic Analysis

1. **The need for draft Rule G-36 and how draft Rule G-36 will meet that need.**

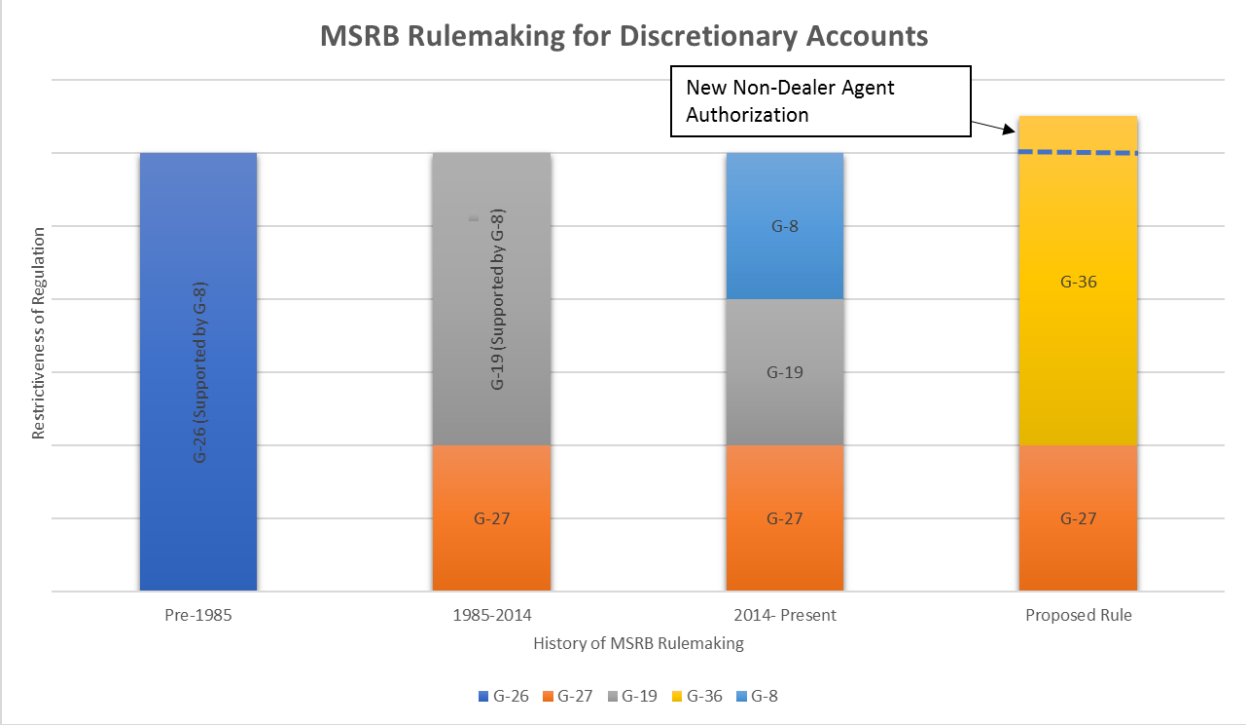
The purpose of draft rule G-36 would be to clarify standards for managing transactions in discretionary accounts and to enhance investor protection for other discretionary transactions in customer accounts. Further, the draft rule is designed to better harmonize the requirements for discretionary transactions with similar rules of the SEC and FINRA.

Specifically, draft Rule G-36 would consolidate and affirmatively articulate requirements for discretionary accounts that are presently implicit in other MSRB rules. By concentrating these requirements in draft Rule G-36, dealers should benefit from greater clarity regarding the requirements for discretionary accounts. Draft Rule G-36 also would create limited, new requirements for the authorization and acceptance of non-dealer agent discretion in customer accounts, which is not addressed by existing MSRB rules but is captured by NYSE Rule 408 (incorporated in the FINRA rulebook).

[30] *See* note 3 *supra*.

2. Relevant baselines against which the likely economic impact of elements of draft Rule G-36 can be considered.

To evaluate the potential economic impact of draft Rule G-36, a baseline must be established as a point of reference in comparison to the expected state with the draft rule in effect. The chart below generally identifies the rules in which requirements related to transactions in discretionary accounts have been contained historically.



In the MSRB's 2014 amendments to Rule G-19, the MSRB eliminated explicit references to discretionary accounts in Rule G-19 and chose, instead, to rely on requirements implicit in, and broader principles captured by, other existing MSRB rules (*e.g.*, Rule G-8, Rule G-17, Rule G-19) to regulate transactions in discretionary accounts. The MSRB intended this more fragmented rule structure to be temporary and indicated, at the time of the rule change in 2014, that it would address discretionary accounts in a separate rule devoted exclusively to the subject at a future date.

In light of the temporary nature of the existing arrangement, it is conceivable that firms may have kept their pre-2014 policies and procedures in place with regard to transactions in discretionary accounts. In addition, the MSRB believes that the burden of the implicit requirements in existing MSRB rules is the same as the burden of the more direct regulation which existed under

the prior rules. Thus, the baseline upon which the impact of the draft rule should be assessed is created by the implicit requirements captured in Rule G-8 and Rule G-27, as well as the quantitative-suitability requirement in Rule G-19, and further supported by fair-dealing obligations under Rule G-17. The new requirement for non-dealer agent discretion is not part of the existing baseline for a small subset of dealers that are not FINRA members subject to NYSE Rule 408.

3. **Identifying and evaluating reasonable alternative regulatory approaches.**

A reasonable regulatory alternative would be to leave certain requirements for discretionary accounts implicit in existing MSRB rules (*e.g.*, Rule G-8 and Rule G-19). However, as elaborated above, the MSRB intended this more fragmented rule structure to be temporary and has planned to address discretionary accounts in a separate rule devoted exclusively to the subject at a future date. Further, consolidating these rules into a single rule and making the implicit requirements for discretionary accounts explicit should reduce confusion and ease compliance, particularly for new entrants in the industry.

Another possible alternative would be to explicitly reference discretionary accounts in the text of the rules where requirements for these accounts is presently implied. This, however, would contradict the action the MSRB took in 2014, would require amendments to multiple MSRB rules and would leave the requirements for discretionary accounts in multiple rules of the rulebook. Consolidating the requirements in a single rule should reduce confusion and assist compliance, while also improving harmonization with similar requirements under SEC and FINRA rules.

Finally, without draft Rule G-36, the new requirements for non-dealer agent discretion either would have to be appended to one of the existing rules or not be codified at all. Neither alternative would be preferable to the current proposal of including the new requirements in draft Rule G-36, as the MSRB believes it would provide an important investor protection from unauthorized trading in customer accounts, particularly for customers of dealers that are not FINRA members, and would better harmonize with FINRA rules (*i.e.*, NYSE Rule 408 incorporated in the FINRA rulebook).

4. **Assessing the benefits and costs of draft Rule G-36 and the related draft amendments and the main alternative regulatory approaches.**

Benefits

Creation of a new Rule G-36 dedicated to the regulation of transactions in discretionary accounts should reduce regulatory uncertainty and enhance investor protection by explicitly and directly imposing conduct standards with which dealers must already comply. Specifically, as described above, draft Rule G-36 would clarify regulatory standards for transactions in discretionary accounts, including the authorization and acceptance of transactions and the prohibition of churning in those accounts. By providing greater clarity for the requirements related to transactions in discretionary accounts, draft Rule G-36 would help ensure dealers are properly complying with those obligations and, therefore, enhance investor protection.

The requirements in draft Rule G-36 would be substantially similar to requirements that were previously directly captured by MSRB rules but have since been indirectly captured by current MSRB rules. In addition, draft Rule G-36 also would address the authorization of discretion by non-dealer agents in customer accounts, which would provide investor protection from unauthorized trading in customer accounts and improve harmonization with FINRA rules.

Costs

Given that draft Rule G-36 would include provisions that are substantially similar to current and previous MSRB requirements related to transactions in discretionary accounts, the costs of complying with the draft rule likely would be minimal, especially given that the only new requirements for dealers would be to obtain written authorization and acceptance of customer accounts in which a non-dealer agent has discretion to effect transactions. In fact, since FINRA already has similar requirements for discretionary transactions by non-dealer agents, presumably most, if not all, FINRA members have established policies and procedures to comply with the requirements; therefore, the transition to include additional municipal securities-related discretionary activities in their policies and procedures should not be overly burdensome or expensive. There also may be some minor ongoing costs associated with review conducted by a principal before each transaction effected by a non-dealer agent. Assuming dealers are in full compliance with the MSRB's current provisions related to transactions in discretionary accounts, the explicit requirements in draft Rule G-36 also may cause dealers to make some minor updates to their policies and procedures.

Effect on Competition, Efficiency and Capital Formation

The MSRB believes that draft Rule G-36 would neither impose a burden on competition nor hinder capital formation. It is possible that increased regulation could incentivize market participants to guide clients towards other types of accounts to avoid the regulatory burden, but this is unlikely

given that the requirements under current MSRB rules related to transactions in discretionary accounts are not significantly different from the requirements in draft Rule G-36. By creating an explicit set of standards for municipal securities transactions in discretionary accounts, draft Rule G-36 may in fact enhance fair competition by helping to ensure full compliance.

Conclusion

On the balance, the MSRB concludes that any burden imposed on dealers by draft Rule G-36 would be necessary and appropriate, and that, as noted above, the benefits from reducing regulatory uncertainty, confusion and risk, as well as enhancing investor protection, should outweigh any associated costs over time.

Request for Comment

The MSRB seeks public comment on the following questions, as well as on any other topic raised in this request. The MSRB particularly welcomes statistical, empirical and other data from commenters that may support their views and/or support or refute the views, assumptions or issues raised in this request for comment.

1) What, if any, systems and business procedures need to be modified to comply with draft Rule G-36 and the related draft amendments?

2) What costs or burdens, direct, indirect, or inadvertent, would draft Rule G-36 and the related draft amendments impose on investors or regulated entities? Are there data or other evidence, including studies or research, that support commenters' cost or burden estimates?

3) Should the MSRB consider including any additional provisions not included in draft Rule G-36 or the related draft amendments, or removing any provisions that may be unjustified or unduly burdensome?

May 16, 2018

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Text of Draft Amendments*

Rule G-8: Books and Records to be Made by Brokers, Dealers, and Municipal Securities Dealers and Municipal Advisors

(a) *Description of Books and Records Required to be Made.* Except as otherwise specifically indicated in this rule, every broker, dealer and municipal securities dealer shall make and keep current the following books and records, to the extent applicable to the business of such broker, dealer or municipal securities dealer:

(i) - (x) No changes.

(xi) *Customer Account Information.* A record for each customer, other than an institutional account, setting forth the following information to the extent applicable to such customer:

(A) - (H) No changes.

(I)(1) with respect to discretionary accounts and consistent with the requirements of Rule G-36(a), the customer's written authorization to exercise discretionary power or authority with respect to the account, written approval of the municipal securities principal or municipal securities sales principal who supervises the account, ~~and~~ written approval of the municipal securities principal or municipal securities sales principal with respect to each transaction in the account, indicating the time and date of approval; and reviews of discretionary accounts to detect and prevent transactions that are excessive in size or frequency; and (2) with respect to other discretionary transactions in customer accounts and consistent with the requirements of Rule G-36(b), the customer's written authorization to the person(s) to exercise discretionary power with respect to the account;

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Rule G-36: Discretionary Transactions in Customer Accounts

(a) *Transactions in Discretionary Accounts*.

(i) No broker, dealer, municipal securities dealer (collectively, "dealer") shall effect a transaction in municipal securities with or for a discretionary account unless the customer has given a signed, dated prior written authorization to exercise discretionary power to a named associated person or associated persons of the dealer and the account documentation has been signed by a municipal securities principal or municipal securities sales principal on behalf of the dealer, other than any associated person vested with discretionary power in that discretionary account, denoting that the account has been accepted in accordance with the dealer's policies and procedures for acceptance of such discretionary accounts. The dealer shall exercise discretionary power in such

* Underlining indicates new language; strikethrough denotes deletions.

account only in the manner, and under the terms and conditions, specified in the customer's prior written authorization.

(ii) The dealer shall not effect with or for such discretionary account any transactions of purchase or sale that are excessive in size or frequency in view of the customer's investment profile as defined in Rule G-19.

(iii) A municipal securities principal or municipal securities sales principal designated by the dealer, other than any associated person vested with discretionary power in a discretionary account, shall approve promptly in writing each order entered in such discretionary account, which shall be marked as discretionary, and shall review such discretionary account at frequent intervals to detect and prevent transactions that are excessive in size or frequency in view of the customer's investment profile as defined in Rule G-19.

(iv) The requirements of this paragraph (a) shall not apply to accounts that are only fee-based.

(b) *Other Discretionary Transactions in Customer Accounts*. No dealer shall accept an order for a customer's account from a person other than the customer unless the customer has given a signed, dated prior written authorization to such person to exercise discretionary power with respect to the account and the order is consistent with such person's authority as specified in the customer's prior written authorization. Where a customer provides written authorization to a natural person, a dealer must obtain the prior dated signature of the named natural person, and where a customer provides written authorization to an entity, a dealer must obtain the prior dated signature of a natural person authorized to act on behalf of the entity, and it must make reasonable efforts to obtain the names of all individuals authorized by the entity to act on behalf of the customer.

---Supplementary Material:
.01 Authorization and Acceptance. For purposes of this rule, the customer authorization and principal acceptance requirements can be satisfied by actual signatures or electronic signatures in a format recognized as valid under federal law to conduct interstate commerce.

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Rule D-10: "Discretionary Account"

(a) The term "discretionary account" shall mean the account of a customer carried or introduced by a broker, dealer, or municipal securities dealer (collectively, "dealer") with respect to which such ~~broker, dealer, or municipal securities~~ dealer is authorized to determine what municipal securities will be purchased, sold or exchanged by or for the account.

(b) A discretionary account will not be deemed to exist if the dealer's discretion is limited to the price at which, or the time at which, an order given by a customer for a purchase or sale of a definite amount of a specified security is executed.