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Dealers Like MSRB Proposed Rules for SMMPs, But Want More.

Dealers generally like the Municipal Securities Rulemaking Board's proposed rules governing sophisticated municipal market professionals, which need less protection than retail investors, but are seeking some clarifications and suggesting the rules be expanded to cover small hedge funds.

They made the requests in comment letters filed Wednesday on MSRB proposed rules, D-15 which would define SMMPs and G-48, which detail dealer regulatory obligations to SMMPs.

The adoption of the rules, as written, would not change the substance of an SMMP notice issued by the MSRB in July 2012, but could allow the board to drastically pare down the many pages of interpretive guidance currently included along with its rule G-17 on fair dealing.

The definitional rule would define an SMMP as a customer of a broker, dealer, or municipal securities dealer that is a financial institution such as a bank, a registered investment advisor, or an investor with assets of at least $50 million. If a customer satisfies any of those requirements and the dealer has a "reasonable basis" to believe the customer is capable of weighing the investment risks appropriately, that investor would be an SMMP under Rule D-15. An investor could affirm, either orally or in writing, that they are an SMMP.

The Securities Industry and Financial Markets Association is generally happy with the MSRB's approach, according to managing director and associate general counsel David Cohen, who authored SIFMA's comments.

"We think they got it right on the substance," Cohen said in an interview.

But SIFMA also told the MSRB that for every rule dealers do not have to comply with in part, or at all, for the rule should state clearly that dealers have fewer or no obligations for SMMPs. When dealing with an SMMP, proposed rule G-48 makes clear the dealer would not have to meet the requirements of Rule G-47 on time of trade disclosure to ensure the dissemination of material information that is readily available. The dealer would also have no obligations under Rule G-18 on transaction pricing to ensure that certain transactions were executed at fair and reasonable prices. There also would be no obligation for the dealer to perform a suitability analysis under rule G-19.

"We think those rules in themselves should say there are reduced obligations to SMMPs," Cohen said.

Cohen also told the board that some of the group's members mentioned a group of customers that do not fall under the SMMP definition as written: hedge funds with assets under management of less than $50 million. SIFMA members believe that such customers could be considered sophisticated despite being smaller, even though Financial Industry Regulatory Authority also uses a $50 million cap to determine sophisticated investors under its suitability rule.

The MSRB used a $100 million cap until a change last year brought it in line with FINRA.

“The MSRB and FINRA should consider expanding the definition of institutional account holders and SMMPs in future rulemaking to include this type of customer,” Cohen wrote.

Cohen also said the proposed rules should be implemented simultaneously with other MSRB rules currently spelled out in G-17 guidance because they are closely related.

The MSRB has said it would send all such rule proposals to the Securities and Exchange Commission at the same time, but Cohen said that is not the same thing as having the same effective dates.

The Bond Dealers of America also expressed support for the MSRB’s proposals but asked the board to consider making it easier to identify an SMMP, as well as make some clarifications in its rulemaking, especially with regard to harmony with FINRA rules.

BDA president and chief executive officer Mike Nicholas, who wrote the group’s comments, said there should be an avenue other than a customer affirmation for identifying SMMPs. For example, if a dealer firm conducts regular reviews of its SMMP customers, it should be able to use such a review as affirmation of SMMP status, as long as the customer’s circumstances have not changed, Nicholas told the MSRB.

The BDA also expressed some concern about the MSRB’s approach to the definition. While Nicholas said that the BDA is comfortable with the $50 million definitional threshold, it has some concerns about the MSRB’s proposed language, which states dealers should consider the type of securities under management. FINRA has no such requirements, Nicholas’ letter points out, and a dealer’s judgment that the customer is an SMMP should suffice.

Once the MSRB has reviewed comments and approved the rules, they would still need to be approved by the SEC before they could take effect.

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