



February 17, 2017

Ronald W. Smith  
Corporate Secretary  
Municipal Securities Rulemaking Board  
1300 I Street NW  
Suite 1000  
Washington, DC 20005

**Re: MSRB Notice 2017-01: Draft Amendments to Modernize MSRB Rule G-26, on Customer Account Transfers**

Dear Mr. Smith:

The Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> appreciates this opportunity to respond to Notice 2017-01<sup>2</sup> (the “Notice”) issued by the Municipal Securities Rulemaking Board (the “MSRB”) in which the MSRB is making a request for comment on draft amendments to MSRB Rule G-26, on customer account transfers. SIFMA and its members support the stated purpose of the draft amendments, but do not agree that the draft amendments are the optimal way to achieve that goal.

**I. The MSRB Should Eliminate Rule G-26**

SIFMA and its members feel strongly that Rule G-26 in its current form is unnecessary. The Rule currently requires the use of the automated customer account transfer service in place at a registered clearing agency registered with the Securities and Exchange Commission (“SEC”). As stated in the Notice, that uniform standard is run by the National Securities Clearing Corporation’s (“NSCC”) Automated Customer Account Transfer Service (“ACATS”)<sup>3</sup>, and the

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<sup>1</sup> SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over \$2.5 trillion for businesses and municipalities in the U.S., serving clients with over \$20 trillion in assets and managing more than \$67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

<sup>2</sup> MSRB Notice 2017-01 (January 6, 2017).

<sup>3</sup> See NSCC Rule 50 (establishing and governing the ACATS process).

ACATS system must be used if both the carrying broker, dealer, or municipal securities dealer (collectively, “dealer”) and the receiving dealer are direct participants in the same clearing agency.

SIFMA recognizes that the MSRB adopted Rule G-26 in 1986 in conjunction with the adoption of similar rules by other self-regulatory organizations (“SROs”) such as the New York Stock Exchange’s (“NYSE”) Rule 412 and the Financial Industry Regulatory Authority’s (“FINRA”, formerly known as the National Association of Securities Dealers) Rule 11870. SIFMA also recognizes that the NYSE and FINRA Rules are only applicable to members of those SROs, and are not applicable to a few municipal securities brokers or municipal securities dealers, particularly those with municipal security-only accounts and bank dealers. It is critical to point out that the firms not covered by the NYSE and FINRA rules are thought to be a small fraction of the total of firms that custody customer accounts that include municipal securities, and those few firms, by and large, are not direct clearing participants of NSCC eligible to participate in ACATS. As such, SIFMA believes that if there are any firms not already covered by NYSE Rule 412 or FINRA Rule 11870 regarding customer account transfers, then it is likely that such a dealer is exempt from participating in ACATS under Rule G-26. It is our opinion that few customer account transfers occur ex-clearing, outside of ACATS. Thus, SIFMA and its members feel that Rule G-26 is redundant.

## **II. If the MSRB Does Not Eliminate Rule G-26, Then the Rule Should Cross-Reference FINRA Rule 11870**

It is important to note that over the intervening years since the adoption of Rule G-26, the MSRB recognizes that Rule G-26, NYSE Rule 412 and FINRA Rule 11870 have not been uniformly updated and conformed to reflect changes to NSCC Rule 50. As a result of G-26 being out-of-date, market participants have largely not been complying with the rule. Instead, market participants have been applying FINRA 11870, which conforms to current NSCC Rule 50 on ACATS procedures. This discordance also leads to confusion among all market participants (investors and dealers alike) and regulatory risk for dealers.

As described in the Notice, SIFMA and its members note that currently NYSE Rule 412 is a direct cross-reference to FINRA Rule 11870 for the purposes of incorporating it into the NYSE rulebook.<sup>4</sup> This cross-reference is beneficial regulatory construction in that it both eliminates any concern that some dealers may not be covered by the rule, and eliminates concerns about a lack of harmonization between the various SRO rules. For these reasons, we feel strongly that if the

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<sup>4</sup> There is also precedent in the MSRB Rulebook for incorporation of other regulator’s rules by reference. *See, e.g.*, MSRB Rule G-41 on Anti-Money Laundering Compliance Program.

MSRB keeps Rule G-26, it should amend Rule G-26 to follow the NYSE model and incorporate FINRA Rule 11870 by reference as follows, “Municipal securities brokers, dealers and municipal securities dealers shall comply with FINRA Rule 11870, concerning the transfer of customer accounts between members, and any amendments thereto, as if such Rule is part of MSRB’s Rules.”<sup>5</sup>

If the primary purpose of the Notice and the draft amendments is to re-establish consistency with ACATS and the rules of other SROs by conforming G-26 to significant updates by the NSCC, the NYSE and FINRA that have relevance to municipal securities, the best way to accomplish this is to have one governing rule that is cross-referenced by the other SROs. Again, this methodology is the most efficient way to reduce confusion and risk to investors, and reduce regulatory risk to dealers. Maintaining a separate substantive Rule G-26 does not further the regulatory goals as stated in the Notice.

### **III. Update and Harmonization of Relevant FINRA Rules is Needed**

SIFMA and its members recognize that irrespective of the approach the MSRB chooses to take regarding Rule G-26, FINRA 11870 must be amended as soon as practicable to reflect the recent amendments to Rule G-12 relating to close-outs.<sup>6</sup> SIFMA suggests that FINRA delete FINRA 11870(f)(1)(J), and insert a new FINRA 11870(2) as follows, “Any fail contracts in municipal securities resulting from this securities account asset transfer procedure shall be included in a member's fail file and closed-out in accordance with MSRB Rule G-12(h), and any amendments thereto, as if such Rule is part of FINRA’s Rules.”

Additionally, SIFMA suggests that FINRA consolidate its provisions that relate to the transfer of securities into FINRA 11870. To that end, we recommend that FINRA 11650 be deleted, and its operative language inserted as new FINRA 11870 Supplementary Material .04.

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<sup>5</sup> Another alternative would be structured similarly to current MSRB Rule G-35 on Arbitration, in that bank dealers who are not NASD members are subject to the NASD Code of Arbitration Procedure as if they were a member of the NASD.

<sup>6</sup> 81 Fed. Reg. 57,960 (Aug. 24, 2016). *See also*, the SEC approval of amendments to MSRB Rule G-12 here: <http://www.msrb.org/~media/Files/SEC-Filings/2016/MSRB-2016-07-SEC-Approval.ashx>.

#### **IV. Nontransferable Assets**

As described in the SIFMA Close-Out Letter I,<sup>7</sup> there are a number of reasons why securities may fail to settle irrespective of whether the accounts was transferred or not. These reasons include operational errors, trading desk errors, customer-based execution errors, a failure to receive securities (creating chains of fails) or a partial call of the securities in between the trade and settlement dates. These reasons, and changing market conditions, may make it difficult or impossible for dealers to buy-in securities or find similar securities. There are clearly benefits to limiting the time any customer's fully paid for securities are long in their account, but allocated to a firm short. Resolving all shorts promptly through compliance with Rules G-12(h), G-26 and FINRA 11870 minimizes issues and concerns about the tax characterization of the interest paid during the settlement period.

In the Notice, the MSRB suggested FINRA amend Rule 11870(c)(1)(D)'s definition of "nontransferable asset" to add new section (vii) which would include any customer long position in a municipal security that allocates to a short position. We disagree with the MSRB's analysis this this amendment would reduce counterparty risk and increase customer confidence. This amendment would be disruptive to industry practice, and outside of standard ACATS procedures. Automated systems fail to be efficient if they require manual processes, such as validating if a long municipal security position is allocated to a short firm position. The more efficient alternative is the use of systems such as NSCC's automated fail clearance system, Reconfirmation and Pricing Service ("RECAPS"), which will match a dealer failing to receive with a dealer failing to deliver. A dealer failing to deliver doesn't impact the ACATS transfer; it is merely a settlement issue.

Dealers may sell propriety products that are municipal securities to customers. FINRA 11870 addresses the transferability of these products.

SIFMA notes that in footnote 24 of the Notice, the MSRB suggests that they believe the carrying party is always in the best position to provide the customer with a list of the specific nontransferable assets and request the disposition of such assets. We disagree. Current industry practice and standard is reflected in FINRA 11870(c), which requires either the carrying party or the receiving party to provide the customer with a list of the nontransferable assets and request the customer's desired disposition of such assets. We believe FINRA 11870(c) is the more appropriate approach.

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<sup>7</sup> See Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, SIFMA, to Ronald W. Smith, Corporate Secretary, MSRB, dated March 6, 2016 (regarding MSRB Notice 2016-02 (Jan. 6, 2016) (the "SIFMA Close-Out Letter I"), available at: <http://www.sifma.org/issues/item.aspx?id=8589959171>).

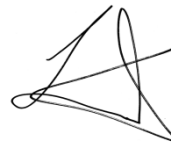
## **V. Economic Costs and Benefits**

SIFMA agrees that existing Rule G-26 is not consistent with the securities industry standard. SIFMA also agrees that the existing rule likely results in uncertainties, inefficiencies and unnecessary costs associated with customer account transfers for all market participants. However, SIFMA believes that the most clear and efficient way to resolve these issues is for dealers to apply FINRA 11870, either directly (due to their FINRA or NYSE membership in the case of the elimination of G-26) or indirectly (as a result of a cross-reference in G-26 to FINRA 11870).

## **VI. Conclusion**

SIFMA and its members support the stated purpose of the draft amendments, but do not agree that the draft amendments are the optimal way to achieve that goal. Again, if the primary purpose of the Notice and the draft amendments is to re-establish consistency with ACATS and the rules of other SROs by conforming G-26 to significant updates by the NSCC, the NYSE and FINRA that have relevance to municipal securities, the best way to accomplish this is to have one governing rule that is cross-referenced by the other SROs. This would be the most efficient way to reduce confusion and risk to investors, and reduce regulatory risk to dealers. Maintaining a separate substantive Rule G-26 does not further the regulatory goals as stated in the Notice. We would be pleased to discuss any of these comments in greater detail, or to provide any other assistance that would be helpful, including working with FINRA to ensure that FINRA 11870 is updated as soon as practicable. If you have any questions, please do not hesitate to contact the undersigned at (212) 313-1130.

Sincerely yours,

A handwritten signature in black ink, appearing to be 'L. Norwood', written over a faint, stylized triangular graphic.

Leslie M. Norwood  
Managing Director and  
Associate General Counsel

Mr. Ronald W. Smith  
Corporate Secretary  
Municipal Securities Rulemaking Board  
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cc: ***Municipal Securities Rulemaking Board***  
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