MSRB
Municipal Securities Rulemaking Board

Regulatory Notice

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Stakeholders
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Request for Comment

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August 25, 2014

Category
Fair Practice

Affected Rules
Rule G-8; Rule G-9

Request for Comment on Revised Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors

Overview

The Municipal Securities Rulemaking Board (MSRB) is seeking comment on a revised draft MSRB Rule G-42 on standards of conduct and duties of municipal advisors when engaging in municipal advisory activities other than the undertaking of solicitations, and on associated revised draft amendments to MSRB Rules G-8, on books and records, and G-9, on the preservation of records (Revised Draft Rules). The MSRB previously sought comment on an initial draft Rule G-42 and initial draft amendments to Rules G-8 and G-9 (Initial Draft Rules). The Revised Draft Rules reflect the modifications made to the Initial Draft Rules after consideration of the comments received.

Comments should be submitted no later than August 25, 2014, 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, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314. All comments will be available for public inspection on the MSRB's website.[1]

Questions about this notice should be directed to Michael L. Post, Deputy General Counsel, at 703-797-6600.

[1] Comments are posted on the MSRB website without change. 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.

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Initial Draft Rules

Following the financial crisis of 2008, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[2] The Dodd-Frank Act establishes a federal regulatory regime requiring municipal advisors to register with the SEC, deeming them to owe a fiduciary duty to their municipal entity clients and granting the MSRB rulemaking authority over them. The MSRB, in the exercise of that authority, is currently developing a regulatory framework for municipal advisors.

On January 9, 2014, the MSRB requested comment on a cornerstone of that regulatory framework, the Initial Draft Rules.[3] Draft Rule G-42 (Duties of Non-Solicitor Municipal Advisors) (the Draft Rule or Initial Draft Rule) addressed the subjects of the core standards of conduct and duties of municipal advisors, other than when soliciting a municipal entity or obligated person.[4] The draft amendments to Rules G-8 and G-9 addressed the subject of the records required to be made and kept by municipal advisors, including provisions specifically related to municipal advisors' compliance with draft Rule G-42.[5] The sections below summarize the provisions of the Initial Draft Rules that are modified in the Revised Draft Rules. For more detail regarding the background of this rulemaking initiative and a complete description of the Initial Draft Rules, the Initial Request for Comment should be consulted.

Standards of Conduct

Draft Rule G-42(a) provided that each municipal advisor in the conduct of its municipal advisory activities for an obligated person client is subject to a duty of care. It also provided that each municipal advisor in the conduct of its municipal advisory activities on behalf of a municipal entity client is subject

[2] Pub. Law No. 111-203, 124 Stat. 1376 (2010) (Dodd-Frank Act).

[3] *See* MSRB Notice 2014-01, *Request for Comment of Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors* (Jan. 9, 2014) (Initial Request for Comment).

[4] As explained in the initial request for comment, Rule G-42 is not intended to address the duties of a municipal advisor when undertaking a solicitation of a municipal entity or obligated person within the meaning of Section 15B(e)(9) of the Exchange Act and the rules and regulations thereunder. The MSRB plans a separate rulemaking with regard to solicitation activities, which may raise issues particular to those activities, at a later date. Municipal advisors engaged in such activities are subject to the MSRB's fundamental fair-practice rule, Rule G-17, which applies to all municipal advisors as well as to brokers, dealers and municipal securities dealers.

[5] Exchange Act Release No. 34-70462, (Sept. 20, 2013), 78 FR 67468 (Nov. 12, 2013) and Exchange Act Release No. 34-71288 (Jan. 13, 2014), 79 FR 2777 (Jan. 16, 2014) (SEC Final Rule).

to a fiduciary duty, which includes, without limitation, a duty of care and a duty of loyalty.

The Supplementary Material in Draft Rule G-42 provided guidance on the meaning of the duty of care and the duty of loyalty (paragraph .01 of the Supplementary Material, on the duty of care and paragraph .02 , on the duty of loyalty). Paragraph .06 of the Supplementary Material clarified that the duties created by the Draft Rule are in addition to any state-law or other duties, including fiduciary duties.

Disclosure of Conflicts of Interest and Other Information

Draft Rule G-42(b) provided that a municipal advisor must fully and fairly disclose to its client in writing all material conflicts of interest, and to do so at or prior to the inception of a municipal advisory relationship. These included any actual or potential conflict of interest that might impair the advisor's ability to render unbiased and competent advice to or on behalf of the client. Draft Rule G-42(b) included a non-exhaustive list of specific items requiring disclosure.

Paragraph .05 of the Supplementary Material of the Draft Rule provided that the conflicts disclosures must be sufficiently detailed to inform the client of the nature, implications and potential consequences of each conflict and must also include an explanation of how the advisor addresses or intends to manage or mitigate each conflict.

Paragraph .07 of the Supplementary Material required the municipal advisor to provide written disclosure to investors of any affiliation that meets the requirements of subsection (b)(ii) of the Draft Rule (paragraph (b)(i)(B) of the Revised Draft Rule), if a document prepared by the municipal advisor or the affiliate is included in an official statement for an issue of municipal securities. This requirement would be satisfied if the municipal advisor's affiliate were to provide written disclosure of the affiliation to investors.

Documentation of the Municipal Advisory Relationship

Draft Rule G-42(c) provided that municipal advisors must evidence each of their municipal advisory relationships by a writing entered into prior to, upon or promptly after the inception of the municipal advisory relationship. The documentation was required to include, at a minimum, certain key terms and disclosures and it was required to be amended as necessary.

Paragraph .04 of the Supplementary Material of the Draft Rule provided that a municipal advisor and its client may limit the scope of the municipal advisory relationship to certain specified activities or services. The municipal

advisor, however, was not permitted to alter the standards of conduct or duties imposed by the Draft Rule with respect to that limited scope.

Advisor Recommendations and Review of Recommendations of Other Parties

Draft Rule G-42(d) provided that a municipal advisor must not recommend that its client enter into any municipal securities transaction or municipal financial product unless the advisor has a reasonable basis for believing that the transaction or product is suitable for the client. The advisor was also required to discuss with its client its evaluation of the material risks, potential benefits, structure and other characteristics of the recommended municipal securities transaction or municipal financial product; the basis upon which the advisor reasonably believes the recommended transaction or product is suitable for the client; as well as whether the municipal advisor has investigated or considered other reasonably feasible alternatives. With respect to a municipal entity client, the Draft Rule provided that an advisor must only recommend a transaction or product that is in the client's best interests.

Paragraph .08 of the Supplementary Material of the Draft Rule provided guidance related to an advisor's suitability obligations. The Draft Rule provided that a municipal advisor's determination of whether a municipal securities transaction or municipal financial product is suitable for the client must be based on factors specified in the guidance.

Paragraph .09 of the Supplementary Material included a "Know Your Client" obligation, which required the advisor to use reasonable diligence to know and maintain essential facts concerning the client and in support of the advisor's fulfillment of its suitability obligations. The facts "essential" to "knowing your client" were specified.

Draft Rule G-42 (e) required a municipal advisor, if requested to do so and if the review of others' recommendations is within the scope of the engagement, to discuss with its client its evaluation of the material risks, potential benefits, structure and other characteristics of the recommended municipal securities transaction or municipal financial product. The advisor was also required to discuss with the client whether the advisor reasonably believes that the recommended transaction or product is suitable for the client and the basis for such belief, as well as whether the municipal advisor has investigated or considered other reasonably feasible alternatives.

Principal Transactions

Draft Rule G-42 (f) prohibited a municipal advisor, and any affiliate of a municipal advisor, from engaging in any transaction in a principal capacity to which the municipal entity or obligated person client of the municipal advisor is a counterparty. To avoid a potential conflict with MSRB Rule G-23, an exception was allowed for activity that is expressly permitted by underwriters under Rule G-23.

Specified Prohibitions

Draft Rule G-42(g) specifically prohibited five types of activities by a municipal advisor. The topics addressed by the prohibitions included compensation, misleading representations related to expertise of the municipal advisor, fee-splitting and payments made to obtain or retain business.

Applicability to Municipal Fund Securities

The regulation of municipal advisors, as the SEC has recognized, [6] is relevant to municipal fund securities.[7] Paragraph .10 of the Supplementary Material of the Draft Rule highlighted the rule's application to municipal advisors whose municipal advisory clients are sponsors or trustees of municipal fund securities.

Books and Records

The Initial Draft Rules included provisions on record keeping to amend Rules G-8 and G-9 to address the books and records that must be made and preserved by municipal advisors registered or required to be registered with the SEC. The SEC Final Rule established a comprehensive record-keeping and preservation regime for municipal advisors.

Draft Rules G-8(h) and G-9 (h), (i), and (j) incorporated by reference all of the record-keeping provisions of the SEC Final Rule. The draft amendments, in addition, included requirements that correspond to certain specific requirements of Draft Rule G-42 that are not necessarily covered by the SEC Final Rule. This included keeping a copy of any document created by a

[6] SEC Final Rule at pages 20-21.

[7] The term "municipal fund security" refers to, among other things, interests in governmentally sponsored 529 college savings plans and local government investment pools and is defined in MSRB Rule D-12 to mean "a municipal security issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940, would constitute an investment company within the meaning of Section 3 of the Investment Company Act of 1940."

municipal advisor that was material to its review of a recommendation made by another party. This also included the keeping of any document that memorializes the basis for any conclusions of the municipal advisor as to suitability. Finally, this included, unless it is included in the official statement for an issue of municipal securities, a copy of any disclosure provided by the municipal advisor, or any affiliate, to investors as required by paragraph .07 of the Supplementary Material.

The draft amendments to Rule G-9 required records to be preserved for not less than five years—the same period required by the SEC Final Rule.

Economic Analysis

The Initial Request for Comment incorporated the MSRB's preliminary economic analysis, as guided by MSRB's policy on economic analysis in rulemaking. The analysis addressed: the need for the draft rule and how the draft rule would meet that need; the relevant baselines against which the likely economic impact of the elements of the draft rule could be considered; reasonable alternative regulatory approaches; and the potential benefits and costs of the draft rule and the main alternative regulatory approaches. The initial request for comment specifically invited comment on the preliminary economic analysis, in addition to comment on all other aspects of the Initial Draft Rules.

Summary of Revised Draft Rule G-42 and Revised Draft Amendments to Rules G-8 and G-9

The MSRB received 44 comments on the Initial Draft Rules.[8] After careful consideration of the comments, the MSRB has determined to make significant modifications as reflected the Revised Draft Rules and request additional comment on the modifications. The significant modifications to the Initial Draft Rules are summarized below, with discussion of related matters raised by commenters.

Standards of Conduct

The Initial Draft Rule did not deem municipal advisors to owe a fiduciary duty to obligated persons, and specifically invited comment on whether the rule should do so and, if so, on any legal impediments to doing so. Commenters generally opposed the existence of a fiduciary duty on the part of municipal advisors to obligated persons under MSRB rules. After carefully considering the comments, Revised Draft Rule G-42(a), on standards of conduct, has not

[8] The comments received by the MSRB on the Initial Draft Rules are available here.

been modified in this regard and follows the Dodd-Frank Act in deeming a municipal advisor to owe a fiduciary duty, for purposes of the rule, only to its municipal entity clients.

Several commenters expressed the view that Draft Rule G-42 implicitly and inappropriately imposed fiduciary duty obligations on municipal advisors whose clients are obligated persons, without a demonstrated need for a more robust regulatory framework than that adopted by Congress or the SEC. The MSRB disagrees and has retained the duty of care as the standard of conduct that would apply to municipal advisors whose clients are obligated persons. Importantly, the MSRB has authority under the Exchange Act to, subject to SEC oversight, adopt rules (with respect to municipal advisory activities) designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, obligated persons, and the public interest.

Many commenters expressed the view that Draft Rule G-42 is overly prescriptive. They suggested that the rule could benefit from a more principles-based approach that would articulate broad principles and standards that could be more readily applied to the multifaceted activities of a wide array of types of municipal advisory firms.

In response to the comments, Supplementary Material .01, which describes the duty of care, is revised to remove the requirement to undertake a thorough review of the official statement. Supplementary Material .02, which describes the duty of loyalty, is also revised to remove the requirement to investigate or consider other reasonably feasible alternatives to any recommended municipal securities transaction or financial product that might also or alternatively serve the municipal entity client's objectives. These changes have been made primarily based on the overarching principle that the client should be empowered to determine the scope of services and control the engagement with the municipal advisor. Supplementary Material .02 has also been revised to articulate the principle that the duty of loyalty precludes a municipal advisor from engaging in municipal advisory activities with a municipal entity client if it cannot manage or mitigate its conflicts in a manner that will permit it to act in the municipal entity's best interests.

Disclosure of Conflicts of Interest and Other Information

Draft Rule G-42(b) required disclosure of all material conflicts of interest, including any fee-splitting arrangements with any provider of investments or services to the client and conflicts that may arise from the use of the form of compensation under consideration or selected by the client. Draft Rule G-42(b) also required disclosure of the amount and scope of coverage of

professional liability insurance that the municipal advisor carries (*e.g.*, coverage for errors and omissions, improper judgments, or negligence), deductible amounts, and any material limitations on such coverage, or a statement that the advisor does not carry any such coverage. Draft Rule G-42(b) further required disclosure of any legal or disciplinary event that is (a) material to the client's evaluation of the municipal advisor or the integrity of its management or advisory personnel; (b) disclosed by the municipal advisor on the most recent Form MA filed with the SEC; or (c) disclosed by the municipal advisor on the most recent Form MA-I filed with the SEC regarding any individual actually engaging in or reasonably expected to engage in municipal advisory activities in the course of the engagement. Finally, Draft Rule G-42(b) provided that, if a municipal advisor concludes that it has no material conflicts of interest, the advisor must provide written documentation to the client to that effect.

The MSRB received comment objecting to a specified requirement to disclose conflicts related to the form of compensation and stating that it might confuse the client and not serve any useful purpose.

In response to the comments, Revised Draft Rule G-42(b)(i)(F) has been modified to specifically require disclosure of material conflicts of interest arising from compensation for municipal advisory activities to be performed only where the compensation is contingent on the size or closing of a transaction as to which the municipal advisor is providing advice.

A commenter objected to the requirement to affirmatively state if the advisor has concluded that it has no material conflicts and stated that if an undisclosed conflict is only later discovered, it would be in violation of the requirement to disclose.

After consideration of the comments, Revised Draft Rule G-42(b) requires an advisor to affirmatively disclose in written documentation that it has "no known" material conflicts of interest based on the exercise of reasonable diligence by the advisor (if that is the case) rather than a more categorical statement.

Some commenters expressed concerns that professional liability insurance is costly, especially for smaller municipal advisors. They stated that the cost of professional liability insurance creates a significant barrier to entry, particularly for smaller firms seeking to enter the municipal advisory industry. One commenter stated that the requirement to disclose the amount and scope of professional liability insurance coverage does not relate to a conflict of interest, material or otherwise, and that, while disclosure may have an

impact on hiring decisions, it does not relate to a municipal advisor's qualifications and does not increase adherence to fiduciary duties. A few commenters described the complications associated with full and fair disclosure of the terms and limitations of policy coverage. In response to the comments, the requirement to disclose the amount and scope of coverage of professional liability insurance that the municipal advisor carries has been removed, though such information may be provided voluntarily or in response to requests from clients or prospective clients.

Some commenters objected to the draft provisions on the disclosure of legal and disciplinary history and suggested that there is ample and detailed disclosure provided about the advisory firm, compensation arrangements, proprietary interests in municipal advisor client transactions, affiliated business entities and disciplinary history of the advisory firm and its associated persons in Forms MA and MA-I that are required to be filed with the SEC.

In response to the comments, the Initial Draft Rule has been revised, and subsection (b)(ii) of the Revised Draft Rule expresses a principle that the municipal advisor must disclose any legal or disciplinary event that is material to the client's evaluation of the municipal advisor or the integrity of its management or advisory personnel. Additionally, Revised Draft Rule G-42(c)(iii) requires the documentation of the advisory relationship to include a description of the type of information regarding legal events and disciplinary history requested by the SEC on Form MA and Form MA-I and information identifying where the client may electronically access the advisor's most recent Form MA and each most recent Form MA-I filed with the SEC. According to Revised Draft Rule G-42(c)(iv), the documentation must also include the date of the last material change to a legal or disciplinary event disclosure on any Form MA or Form MA-I filed with the SEC by the municipal advisor, which will alert the client to any material changes that have occurred to the information previously provided to the SEC and that may have been previously reviewed by the client.

Some commenters expressed the view that Draft Rule G-42 failed to address adequately issues associated with the provision of inadvertent or incidental advice which may cause a firm to be considered to be a municipal advisor under the SEC Final Rule. Commenters stated that, in other cases, if advice was provided to a company that was not identified as an obligated person, the party that provided the advice may unknowingly cause itself to be considered a municipal advisor. Similarly, commenters observed that a firm could render advice and trigger the application of certain provisions of the Initial Draft Rule absent a decision by the firm and the prospective client to

enter into a client relationship. This could implicate the application of requirements to disclose conflicts of interest and requirements for the documentation of the municipal advisory relationship.

In response to the comments and because disclosure and documentation requirements in certain circumstances would be impractical and unwarranted, a new provision is added, Supplementary Material .06. It addresses the steps that may be taken if the party inadvertently engaged in municipal advisory activities does not intend to continue the municipal advisory activities or enter into a municipal advisory relationship and elects to seek a safe harbor from the requirements of sections (b) and (c) of Revised Draft Rule G-42 relating to disclosure of conflicts of interest and documentation of the municipal advisory relationship.

The Revised Draft Rule provides that the client must be promptly provided with a document that is dated and includes: a disclaimer that the advisor did not intend to provide advice and that, effective immediately, it has ceased engaging in municipal advisory activities; a notification that such municipal entity or obligated person should be aware that the disclosure of material conflicts of interest and other information as required by the rule has not been provided; a representation by the advisor that it, in good faith, has undertaken reasonable efforts to identify the advice that was inadvertently provided; and a request that the municipal entity or obligated person acknowledge receipt of the documentation. The advisor utilizing this alternative is also required to conduct a review of its supervisory and compliance policies and procedures for the purpose of ensuring that they are reasonably designed to prevent the provision of inadvertent advice to municipal entities and obligated persons.

Documentation of the Municipal Advisory Relationship

Under Draft Rule G-42(c), the documentation of the municipal advisory relationship was required to include provisions relating to compensation; the scope of municipal advisory activities to be performed and any limitations on the scope of the engagement; the specific undertakings, if any, requested by the client to be performed by the advisor relating to the preparation or finalization of the official statement or similar disclosure document; and the termination of the municipal advisory relationship. Draft Rule G-42(c) also required that the municipal advisor amend or supplement the writing during the term of the municipal advisory relationship as necessary to reflect changes in or additions to the terms or information required to be disclosed by section (b) or (c), except changes in the reasonably expected amount of compensation were only required to be updated if the change was material. The amendment and supplementation requirement in Draft Rule G-42(c)

applied to any changes and additions that were discovered, or should have been discovered, based on the exercise of reasonable diligence by the municipal advisor.

A commenter suggested that the materiality standard should apply for all updates related to disclosures required in the documentation of the municipal advisory relationship, not just those relating to compensation. Another commenter supported acknowledgment of conflicts of interest disclosure and yet another commenter supported the concept of informed consent, confirmed in writing, and said that the acknowledgment does not need to be a separate, stand-alone document; it could be in the form of a writing evidencing the engagement, so long as it was after the disclosure of conflicts of interest. One commenter stated that a municipal advisor should be permitted to proceed with a municipal advisory engagement in the absence of receipt of a written acknowledgment of the conflicts disclosure and consent, if the municipal advisor has a reasonable belief that such information has been received.

One commenter stated that, as with other fiduciary standards, the rule should provide for the withdrawal from, and termination of, municipal advisory relationships. The commenter also stated that the rule should ensure that any withdrawal or termination of the advisory relationship complies with fiduciary standards. The commenter suggested that the rule, or guidance, should state that, when a municipal advisory relationship is no longer in existence, the advisor no longer owes duties to its former client. Another commenter stated that the rule should provide when and how municipal advisors withdraw or terminate the advisory relationship.

In response to the comments, the Revised Draft Rule simplifies the documentation of compensation and requires that the documentation include only the form and basis of any direct and indirect compensation. Though no longer required by the Revised Draft Rule, the parties may agree to document the reasonably expected amount of compensation and may agree to state such amount in dollars to the extent it can be quantified. Also removed from the Revised Draft Rule is the requirement to detail, in the case of municipal advisory activities relating to a new issue or reoffering of municipal securities, the specific undertakings, if any, requested by the client to be performed by the advisor relating to the preparation or finalization of the official statement or similar disclosure document. Additionally, the Revised Draft Rule provides that the documentation of the advisory relationship is required to include any terms relating to withdrawal from the relationship and must be amended and supplemented only if there are material changes or additions.

Recommendations and the Review of Recommendations of Others
The Initial Draft Rule provided that an advisor must not recommend that its client enter into any transaction or financial product unless the advisor had a reasonable basis for believing the transaction or financial product was suitable for the client. One commenter suggested that because a municipal advisory relationship could, just like the attorney-client relationship, include a wide spectrum of activities, the terms of the engagement should govern the tasks that a municipal advisor must perform in providing its advice. This commenter believed that a municipal advisor should be free to recommend a transaction based on facts given to it by its client, without exercising any diligence to check the facts, if consistent with the engagement, and that a municipal advisor also should be free to provide advice regarding, or otherwise recommend, a pricing of a transaction even if it does not believe that the transaction is preferable to other possible transactions. In addition, this commenter stated that a municipal advisor should be permitted to recommend a range of transactions that would be in the client's interests, even though only one could be in the client's best interests.

The Initial Draft Rule required a municipal advisor, when requested to do so by its client and within the scope of the engagement, to undertake a thorough review of another party's recommendation. The Initial Draft Rule further required that certain matters be "discussed" with the client in the course of the review. One commenter stated that this would require excessive recordkeeping associated with defensive documentation in order to show compliance with the provisions of the Initial Draft Rule.

After carefully considering the comments, the provisions of the Revised Draft Rule relating to recommendations made by the advisor and the advisor's review of recommendations of other parties are merged. The merged provisions retain the diligence standard in connection with each kind of undertaking. The merged provisions, however, clarify that the client (with the agreement of the municipal advisor) will control the scope of the engagement. Revised Draft Rule G-42(d) provides that, if a municipal advisor makes a recommendation of a municipal securities transaction or municipal financial product, or if the review of a recommendation of another party is requested by the municipal entity or obligated person client and within the scope of the engagement, the municipal advisor must determine, based on the information obtained through reasonable diligence, whether a recommended transaction or financial product is suitable for the client. Revised Draft Rule G-44(d) allows the advisor to inform the client of certain matters rather than retaining the provisions of the Initial Draft Rule that required the topics to be "discussed." A municipal advisor is allowed to

choose the appropriate method by which to communicate its evaluation of the material risks and benefits attendant to the recommendation.

Principal Transactions

Draft Rule G-42(f) prohibited a municipal advisor, and any affiliate of a municipal advisor, from engaging in any transaction in a principal capacity to which the municipal entity or obligated person client of the municipal advisor is a counterparty. In the initial request for comment, the MSRB specifically sought comments on whether a prohibition of principal transactions by municipal advisors was the appropriate regulatory approach. The initial request asked, for example, whether an advisor (or its affiliate) should be permitted to engage in certain types of principal transactions with its client, with full and fair disclosure and written client consent. And the initial request asked, if so, what types of principal transactions should be allowed. The initial request also asked whether the treatment of principal transactions should differ based upon whether or not a municipal advisor owes a fiduciary duty to the client.

In response to the Initial Request for Comment, many commenters expressed concerns with respect to the proposed prohibition of principal transactions by municipal advisors with their clients. Several commenters interpreted the prohibition as covering activities and transactions that are unrelated to the municipal advisory relationship. Other commenters viewed the application of the prohibition to transactions with obligated persons as overreaching because it, according to the commenters, inappropriately treats them as benefitting from a fiduciary duty. Many commenters stated that other fiduciary regimes do not completely prohibit principal transactions, and the ban should be significantly narrowed and should not apply in any event to affiliates. One commenter objected to the ban extending to affiliates regardless of the extent of the connection of the principal transaction between the non-municipal advisor and the municipal advisory relationship. The commenter stated that the risk of conflicts of interest is significantly diminished because affiliates provide different services or have different governance structures and information barriers. Other commenters expressed concerns related to regulating conduct of affiliates of municipal advisors, specifically the imposition of compliance burdens on the affiliates and possible unintended consequences to clients if certain products and services offered by affiliates of the municipal advisor were no longer available to clients. Finally, many commenters sought clarification of the definition of principal transaction or “principal capacity.”

After carefully considering the comments, the MSRB has, in the Revised Draft Rule, clarified and significantly narrowed the scope of the proposed

prohibition of principal transactions. Revised Draft Rule G-42(e)(ii)[9] prohibits a municipal advisor (and its affiliate) to a municipal entity client from "engaging in a principal transaction" directly related to the same municipal transaction or financial product as to which the municipal advisor is providing advice. It provides that a municipal advisor to a municipal entity client is prohibited from certain principal transactions, but there is no specific prohibition or disclosure-and-consent requirement in the Revised Draft Rule for a municipal advisor to an obligated person client. Importantly, municipal advisors are subject to the MSRB's fundamental fair-practice rule, Rule G-17, which applies to the conduct of all of their municipal advisory activities. The exception in the Revised Draft Rule to the prohibition on principal transactions that is included to avoid a possible conflict with Rule G-23 is located in Supplementary Material .07, and is clarified through the use of terminology from Rule G-23 rather than solely through a cross-reference.

Also in response to comments, Revised Draft Rule G-42(f)((i) adds, for purposes of the Revised Draft Rule, a definition of the term "engaging in a principal transaction" – "when acting as a principal for one's own account, selling to or purchasing from the municipal entity client any security or entering into any derivative, guaranteed investment contract, or other similar financial product with the municipal entity client." This definition draws on the statutory language that addresses principal transactions in the Investment Advisers Act.[10] These modifications are designed to exclude many of the transactions that some commenters read as potentially covered by the Initial Draft Rule, including the taking of a cash deposit or the payment by a client solely for professional services.

Specified Prohibitions

Draft Rule G-42(g) included provisions that specifically prohibited an advisor from receiving excessive compensation and making or participating in any fee-splitting arrangements with underwriters.

One commenter was not opposed to the prohibition on fee-splitting but requested a clear definition of "fee-splitting arrangements" that would recognize that a municipal advisor's utilization of independent contractors and subcontractors in connection with particular engagements would fall outside of any such definition. One commenter stated that allowing an investment provider to pay fees related to the solicitation of the investment by the municipal advisor, and that are within the permitted limits of the

[9] The prohibition of certain principal transactions is provided in Revised Draft Rule G-42(e)(ii) as one of the "specified prohibitions."

[10] Section 206(3) of the Investment Advisers Act, 15 U.S.C. 80b-6(3).

Internal Revenue Service rules, should be acceptable so long as they are disclosed to the issuer and each investment provider on the bid list. Two commenters stated that fee-splitting should be disclosed but not prohibited and provided one example of fee-splitting with a structuring agent to provide specific quantitative services on a transaction and another example of a situation where a municipal entity or obligated person may want its municipal advisor or other professionals (including underwriters, if after the underwriting period) to receive compensation from investment providers or other service providers for providing oversight and performing other services. The commenter stated that in the case of the latter example, this should not be prohibited if there is written full and fair disclosure of any fee-splitting or fee-sharing arrangements.

One commenter recommended that the MSRB clarify that the prohibition on fee-splitting with underwriters applied "on any issue for which it is serving as municipal advisor" because the failure to link the prohibition to the actual advisory engagement many lead to unintended consequences. The MSRB agrees with this commenter and, in response, the Revised Draft Rule clarifies that the prohibition applies to fee-splitting with underwriters on any municipal securities transaction for which it is acting as municipal advisor.

One commenter questioned the standard that would be used to evaluate whether compensation was excessive. Another commenter stated that in some circumstances certain transaction fees are meant to compensate the advisor for other activities unrelated to the specific issuance or reoffering of municipal securities in connection with which the fee is being paid and asked whether this practice was permitted.

In response to the comments, Revised Draft Rule G-42 includes paragraph .11 of the Supplementary Material to provide guidance on factors that may be relevant to whether a municipal advisor's compensation is excessive, including: the municipal advisor's expertise, the complexity of the municipal securities transaction or the financial product, whether the fee is contingent upon the closing of the transaction or financial product, the length of time spent on the engagement and whether the advisor is paying any other relevant costs related to the transaction or financial product. Regarding the other commenter's question, the Revised Draft Rule, like the Initial Draft Rule, prohibits receiving compensation that is excessive in relation to the municipal advisory activities actually performed and also prohibits invoices that do not accurately reflect the services actually performed. Depending on the facts and circumstances, either or both of these provisions could apply to a scenario like that posited by the commenter. The Revised Draft Rule,

however, does not speak to the client's decision regarding the source of funds for the payment of fees for services rendered by the municipal advisor.

Another commenter stated that the specific prohibition against inaccurate invoices (subsection (g)(ii) of the Initial Draft Rule) should be modified to apply only to inaccuracies resulting in an *overstatement* of fees, expenses, etc., to allow an advisor to *understate* or forgo part of an amount (in the advisor's discretion). Revised Draft Rule G-42(e)(i)(B) is unchanged from the Initial Draft Rule, and prohibits delivering an invoice for fees or expenses for municipal advisory activities that does not accurately reflect the activities actually performed or personnel that actually performed those services--it does not prohibit an advisor from offering a payment discount for services actually performed. The MSRB believes an advisor would be free to accurately disclose on its invoice the amount of any discount.

Definitions

Many commenters stated that the Initial Draft Rule should be harmonized with the SEC Final Rule and should state clearly that it does not apply to activities that have been excluded or exempted under either the Dodd-Frank Act or the SEC Final Rule. The references in the Initial Draft Rule to the Exchange Act and the rules and regulations thereunder encompassed the statutory exclusions and the rule-based exemptions. Nevertheless, each of the definitions of "advice," "municipal advisor," "municipal entity" and "obligated person" has been modified in Revised Draft Rule G-42(f)(ii), (iv), (vii) and (viii) and now specifically reference the applicable provisions of the SEC Final Rule to address commenters' concerns.

Finally, Revised Draft Rule G-42(f)(vi) includes language that clarifies when the municipal advisory relationship begins and ends. This clarification is important given, among other reasons, that an advisor is required to evidence each of its municipal advisory relationships in a writing that must be promptly amended to reflect any material changes or additions.

Application to Other Types of Municipal Securities

Some commenters stated that the Initial Draft Rule may be unworkable when applied to advisors advising municipal entities regarding municipal fund securities (such as local government investment pools or 529 college savings plans), advisors to certain state and local funds (such as state and local retirement funds or any state and local fund investing bond proceeds) or

advisors to other investment funds (such as real estate funds) that may from time-to-time comingle bond proceeds with funds from other investors.[11]

One commenter stated that a fund manager or adviser that provides offering materials to investors in its fund and obtains executed subscription agreements or other organizational agreements should not be required to provide separate "writings" to fund investors who are municipal entities or obligated persons. The MSRB, at this juncture, does not intend to create an exemption for these types of advisors and believes that it is appropriate to require them to either create a separate writing or adapt the subscription agreement language or other written materials to conform to the requirements of Revised Draft Rule G-42.

One commenter recommended that the MSRB provide that a municipal advisor is not required to investigate whether information is materially inaccurate or complete if it was provided by persons who are authorized by a municipal entity client to act on behalf of a state's 529 college savings plan. Another commenter stated that in the context of 529 plans, municipal advisors receiving information from the trustees and sponsors of such plans would not be in a position to verify the accuracy or completeness of information provided by authorized state employees and officials.

Paragraph .01 of the Supplementary Material of the Revised Draft Rule provides, as a core general standard, that a municipal advisor must make a reasonable inquiry as to the facts that are relevant to a client's determination as to whether to proceed with a course of action or that form the basis for any advice provided to the client and it also provides that an advisor must undertake a reasonable investigation to determine that it is not basing any recommendation on materially inaccurate or incomplete information. The Revised Draft Rule does not provide an exception for information that is provided to the advisor by the client. In addition, the MSRB believes that in some circumstances the information may be provided to the advisor by the client in connection with the preparation of the official statement. Paragraph .01 of the Supplementary Material of the Revised Draft Rule provides that a municipal advisor must have a reasonable basis for any information provided by the advisor to the client or other parties involved in the municipal securities transaction in connection with the preparation of an official

[11] To help address various general concerns about the scope of municipal advisory activities, the SEC has provided transitional guidance for identifying proceeds of municipal securities for market participants who prior to July 1, 2014 have deposited proceeds of municipal securities in existing accounts and invested such proceeds in existing investments held by certain market participants. *See* SEC FAQ 11.1 (updated May 19, 2014).

statement. The MSRB believes at this juncture that the provisions of the Revised Draft Rule are appropriate and does not believe that advisors to 529 plans should be relieved from an obligation to inquire as to material provided by it to its client or other parties in connection with the preparation of an official statement.

Two commenters stated that Supplementary Material .07 required, among other things, the provision of written disclosure to investors of certain affiliations and that a municipal advisor generally will not have access to information about the 529 plan's investors or how to contact them and would therefore be unable to provide the required disclosure. One of the commenters stated the advisor may have no control over the content of the official statement used by the plan or its underwriter, so it would be unable to require the plan or its underwriter to include the required disclosure in such document. Notably, this requirement, according to the last sentence of Supplementary Material .08, would be satisfied if the advisor's affiliate were to provide written disclosure of the affiliation to investors. The purpose of these disclosures would be to alert investors to the affiliation.

One commenter stated that many of the disclosures included in Draft Rule G-42(b) could be inapplicable in the context of an advisory relationship with a 529 plan. The MSRB believes that application of section (b) is warranted because advisors to 529 plans may have material conflicts of interest including those that may arise in connection with affiliates of an advisor that may be registered investment companies that are included in one or more of the investment options in the 529 plan to or on behalf of which the advisor is providing advice.

Books and Records

The Initial Draft Rules included provisions on record keeping to amend Rules G-8 and G-9 to address the books and records that must be made and preserved by municipal advisors registered or required to be registered with the SEC.[12] One commenter expressed concerns that, in order to maintain proper books and records of any evaluations and recommendations made by a municipal advisor, a number of discussions that typically occur verbally

[12] The Initial Draft Rules included fundamental books and records provisions intended to become effective with the first major municipal advisor rule since the SEC's adoption on September 18, 2013, of the SEC Final Rule. Because the MSRB is requesting additional comment and then will be reviewing the comments received on the Revised Draft Rules, these provisions are removed and the MSRB plans to include them in a separate rulemaking initiative. These provisions of the Initial Draft Rules would have added Rule G-8(h)(i) and Rule G-9(i), (j) and (k), and amended Rule G-9(e) and (f).

between an issuer and its advisor would need to be memorialized in writing, which may be of concern to issuers and impractical for advisors. The commenter stated that, if these discussions and alternatives are memorialized, this may affect the decision-making process and how much information an issuer may be willing to disclose to its advisor. The commenter stated that the MSRB should describe in more detail exactly what records a municipal advisor will need to retain and asked if a municipal advisor needs to know whether it should retain records or copies of all the proposals it receives, only those it receives and reviews at the specific request of the issuer, or only those it receives, reviews and recommends to the issuer.

Draft Rule G-8(h)(ii)(A) did not require a municipal advisor to make and keep a copy of any document unless the municipal advisor already has created the document. It required a municipal advisor to make and keep current a "copy of any document created by the municipal advisor that was material to its review of a recommendation by another party or that memorializes the basis for any conclusions as to suitability." In addition, the Draft Rule did not require that a record be created of an advisor's evaluations or recommendations.[13] The Initial Draft Rules left the determinations regarding record creation in this respect to the municipal advisor in its professional and business judgment, and then required the preservation of copies of documents that the municipal advisor determined to create.

One commenter requested that the MSRB provide a draft of a prototype baseline policies and procedures guide that smaller municipal advisor firms can adopt or modify, as needed, to assist firms with this type of endeavor. The MSRB has declined at this time to do so in part because it may be impracticable for the MSRB to develop policies and procedures that would appropriately address the scope and diversity of business models and particular practices of the numerous municipal advisor firms.

One commenter requested that the MSRB clarify that maintenance of documents and emails on a firm's email site or through its internet service provider will comply with the record retention requirements. The draft amendments to Rule G-9 contain relatively principles-based requirements for retention, including that records be available for ready retrieval, inspection and production of copies. The draft amendments to Rule G-9 do not

[13] SEC Rule 15Ba1-8 requires an advisor to keep records of all written communications received and sent by such advisor relating to municipal advisory activities and a copy of any document created by the advisor that was material to making a recommendation to a municipal entity or obligated person or that memorializes the basis for that recommendation.

prescribe the specific details of how or where electronic records must be preserved. Additionally, if a municipal advisor would prefer to comply with the SEC's electronic record retention requirements (SEC Rule 15Ba1-8(d)), as interpreted by the SEC, the draft amendments to Rule G-9 provide that alternative.

Economic Considerations

As noted above, the initial request for comment incorporated the MSRB's preliminary economic analysis, as guided by MSRB's policy on economic analysis in rulemaking. This analysis examined likely benefits and costs of the Draft Rule, relative to appropriate baselines and reasonable alternatives. As summarized below, much of that preliminary analysis applies to the Revised Draft Rules, and the MSRB believes that, overall, the significant modifications made likely will reduce costs as compared with the Initial Draft Rules.

Benefits.

The MSRB believes that the Revised Draft Rule will provide several likely benefits by enhancing protections to municipal bond issuers and investors and by providing guidance to municipal advisors for complying with the requirements of the Dodd-Frank Act.

First, The MSRB believes the Revised Draft Rule will enhance municipal entity and obligated person protections by ensuring that these entities have available to them sufficient information to make meaningful choices about engaging a municipal advisor. These protections would also be enhanced as a result of the Revised Draft Rule's guidance for municipal advisors that may assist these advisors in complying with, or help prevent breeches of, their fiduciary and fair dealing duties. To the extent that this guidance increases the likelihood of compliance by municipal advisors, municipal entities and obligated persons will benefit. Investors in municipal bond offerings should also benefit from the Revised Draft Rule to the extent that a municipal entity issuing bonds that uses a municipal advisor is more likely to receive services that reflect a higher ethical and professional standard than otherwise would be the case.

Second, the Revised Draft Rule provides needed guidance and clarification with respect to the standards of conduct and duties of a municipal advisor that would meet the purposes of the Dodd-Frank Act and the SEC Final Rule. The Revised Draft Rule also prescribes for municipal advisors means that will prevent breaches of these duties. Therefore, this guidance provides a benefit to municipal advisors who could otherwise face greater uncertainty about the standards of conduct and duties required to meet certain of the requirements

of the Dodd-Frank Act, particularly given the regulatory framework for municipal securities regulation involving multiple enforcement organizations.

Third, the MSRB believes that a benefit of the Revised Draft Rule may follow from the increased level of information disclosed to clients by municipal advisors relative to the baseline, which may lead to an improvement in the selection of municipal advisors. As a result of the information disclosed through the Revised Draft Rule, municipal entities and obligated persons may be able to more easily establish objective criteria to use in selecting municipal advisors and may increase the likelihood that municipal advisors are hired because of their qualifications as opposed to other reasons.

Fourth, the Revised Draft Rule should also result in improved quality-based competition among municipal advisors to the extent that the clients of municipal advisors rely on this disclosed information in the municipal advisor selection process.

Costs.

The Board recognizes that municipal advisors would incur costs, relative to the baseline state, to meet the standards of conduct and duties contained in Revised Draft Rule and the revised amendments to Rules G-8 and G-9. These costs may include additional compliance costs and additional record-keeping costs.

First, to ensure compliance with disclosure obligations of the Revised Draft Rule, municipal advisors may incur costs by seeking advice from legal and compliance professionals when preparing disclosures to clients. However, the Board believes that some of these costs are accounted for in the baseline requirements of the SEC final municipal advisor rules which require disclosure of at least some similar information, such as the disclosure of disciplinary history. Revised Draft Rule G-42 may impose additional costs on municipal advisors as it requires disclosure of additional information and requires that information be disclosed directly to clients rather than through submissions to a regulator. The magnitude of these additional costs, however, is not quantifiable using available data.

Second, municipal advisors may incur additional record-keeping costs as a result of the Revised Draft Rule. The Board considers existing requirements in the SEC's municipal advisor rules on record keeping and record preservation to serve as a baseline. As the SEC recognized in its economic analysis of its recordkeeping requirements, municipal advisors should already be maintaining books and records as part of their day-to-day operations. In addition, municipal advisors who are also registered as broker-dealers or

investment advisors are currently subject to the record-keeping requirements of those regulatory frameworks. Against these baselines, the Board believes that the costs associated with the few additional record-keeping requirements associated with Revised Draft Rule G-42 will not be significant.

The Initial Request for Comment specifically invited comment on the preliminary economic analysis. Commenters cited four features of the rule they believed were potentially costly and burdensome and therefore deserving of careful consideration by the MSRB.

First, many commenters expressed concerns about the potential breadth of the draft prohibition of principal transactions by municipal advisors with their clients. As noted, the MSRB has clarified and significantly narrowed the scope of this prohibition in the Revised Draft Rule.

Second, commenters expressed concerns about the cost for a firm to document whether any of its affiliates has a business relationship with any of the municipal advisor affiliate's clients. These costs arise from developing and implementing systems to enable tracking of affiliate relationships with municipal advisor clients. Commenters asserted that these costs were incurred without any tangible benefit to municipal entity or obligated person clients.

Third, commenters cited professional liability insurance as costly, especially for smaller municipal advisors. Commenters asserted that the cost of professional liability insurance created a significant barrier to entry, particularly for smaller firms seeking to enter the municipal advisory arena. As noted, the MSRB has deleted the specific disclosure requirement related to professional liability insurance from the Revised Draft Rule.

Fourth, commenters believed that a portion of the costs associated with the Initial Draft Rule would be passed along to municipal entity and obligated person clients in the form of higher fees. The MSRB believes that any increase in municipal advisory fees attributable to the additional costs of the Revised Draft Rule compared with the baseline state will be, in the aggregate, low and that the cost per municipal advisory firm will be spread across the number of advisory engagements for each firm. The MSRB recognizes, however, that for smaller municipal advisors with fewer clients, the cost of compliance with the Revised Draft Rule's standards of conduct and duties may represent a greater percentage of annual revenues, and thus, such advisors may be more likely to pass those costs along to their advisory clients

The MSRB recognizes that, as a result of these costs, some municipal advisors may decide to exit the market, curtail their activities, consolidate with other firms, or pass the costs on to municipal entities and obligated persons in the form of higher fees. While the Board recognizes that some municipal advisors may exit the market as a result of the costs associated with the Revised Draft Rule relative to the baseline, the Board believes municipal advisors may exit the market for a number of reasons, including business reasons separate from reasons involving the costs associated with the Revised Draft Rule. The Board believes that municipal advisors that have been subject to past disciplinary actions may decide to exit the market rather than disclose that information directly to clients, which could improve the quality of the market for municipal advisory services and, therefore, benefit municipal entities and obligated persons. The Board recognizes that some of the municipal advisors that may exit the market could be small entity municipal advisors that exit the market for financial reasons and that such exits from the market may lead to a reduced pool of municipal advisors.

The MSRB has also considered the possibility that some compliance costs could be greater in the absence of the Revised Draft Rule. By articulating the duties and obligations of municipal advisors and by prescribing means that will prevent breaches of these duties, the Revised Draft Rule may reduce possible confusion and uncertainty about what is required in order to comply with relevant provisions of the Dodd-Frank Act. Therefore, the Revised Draft Rule may reduce certain costs of compliance that might have otherwise been incurred by allowing municipal advisors to more quickly and accurately determine compliance requirements.

Request for Comment

The MSRB requests comments on Revised Draft Rule G-42 and the revised draft amendments to Rules G-8 and G-9. In addition to any other subject that commenters wish to address related to the Revised Draft Rules, the MSRB particularly welcomes any statistical, empirical and other data from commenters that may support their views and/or support or refute the views or assumptions contained in this request for comment.

July 23, 2014

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Text of Proposed Amendments[14]

Rule G-42: Duties of Non-Solicitor Municipal Advisors

(a) *Standards of Conduct.*

(i) A municipal advisor to an obligated person client shall, in the conduct of all municipal advisory activities for that client, be subject to a duty of care.

(ii) A municipal advisor to a municipal entity client shall, in the conduct of all municipal advisory activities for that client, be subject to a fiduciary duty that includes a duty of loyalty and a duty of care.

(b) *Disclosure of Conflicts of Interest and Other Information*. A municipal advisor must, ~~at~~upon or prior to ~~the inception of a~~engaging in municipal advisory ~~relationship~~activities, provide ~~the~~to the municipal entity or obligated person client ~~with a document making~~ full and fair disclosure in writing of:

(i) all material conflicts of interest, including ~~disclosure of~~:

~~(i)~~(A) any actual or potential conflicts of interest of which it is aware after reasonable inquiry that might impair its ability either to render unbiased and competent advice to or on behalf of the obligated person client or to fulfill its fiduciary duty to the municipal entity client, as applicable;

~~(ii)~~(B) any affiliate of the municipal advisor that provides any advice, service, or product to or on behalf of the client that is directly or indirectly related to the municipal advisory activities to be performed by the disclosing municipal advisor;

~~(iii)~~(C) any payments made by the municipal advisor, directly or indirectly, to obtain or retain the client's municipal advisory business;

~~(iv)~~(D) any payments received by the municipal advisor from third parties to enlist the municipal advisor's recommendation to the client of its services, any municipal securities transaction or any municipal financial product;

~~(v)~~(E) any fee-splitting arrangements involving the municipal advisor and any provider of investments or services to the client;

[14] The proposed amendments to Draft Rule G-42 as indicated here include markings to show changes from the text of the proposed amendments that were contained in the Initial Request for Comment, MSRB Notice 2014-01. The proposed amendments to Draft Rules G-8 and G-9 are indicated here through comparison with the existing text of the MSRB Rule Book. Underlining indicates new language; strikethrough denotes deletions.

~~(vi)~~(F) any conflicts of interest ~~that may arise~~arising from ~~the use of the form of~~ compensation ~~under consideration or selected by the client for the~~for municipal advisory activities to be performed~~;~~ that is contingent on the size or closing of any transaction as to which the municipal advisor is providing advice; and

~~(vii)~~(G) any other engagements or relationships ~~of the municipal advisor or any affiliate~~ of the municipal advisor that might impair the advisor's ability either to render unbiased and competent advice to or on behalf of the obligated person client or to fulfill its fiduciary duty to the municipal entity client, as applicable~~;~~.

~~(viii) the amount and scope of coverage of professional liability insurance that the municipal advisor carries (*e.g.*, coverage for errors and omissions, improper judgments, or negligence), deductible amounts, and any material limitations on such coverage, or a statement that the advisor does not carry any such coverage; and~~
If a municipal advisor concludes that it has no known material conflicts of interest based on the exercise of reasonable diligence by the advisor, the municipal advisor must provide written documentation to the client to that effect.

~~(ix)~~(ii) any legal or disciplinary event that is ~~(a)~~ material to the client's evaluation of the municipal advisor or the integrity of its management or advisory personnel~~; (b) disclosed by the municipal advisor on the most recent Form MA filed with the Commission; or (c) disclosed by the municipal advisor on the most recent Form MA-I filed with the Commission regarding any individual actually engaging in or reasonably expected to engage in municipal advisory activities in the course of the engagement. If a municipal advisor has disclosed a legal or disciplinary event on any form referenced in section (b) or (c) of this rule, the advisor must provide the client with a copy of the relevant sections of the form or forms~~.

~~If a municipal advisor concludes that it has no material conflicts of interest, the municipal advisor must provide written documentation to the client to that effect.~~

(c) *Documentation of Municipal Advisory Relationship*. A municipal advisor must evidence each of its municipal advisory relationships by a writing entered into prior to, upon or promptly after the ~~inception~~establishment of the municipal advisory relationship. The writing must be dated and include, at a minimum,

(i) the form and basis of direct or indirect compensation, if any, for the municipal advisory activities to be performed;

(ii) the ~~reasonably expected amount of any such compensation (stated in dollars to the extent it can be quantified);~~

~~(iii)~~ the information ~~regarding conflicts of interest and other matters that is~~ required to be disclosed by section (b) of this rule;

(iii) a description of the type of information regarding legal events and disciplinary history requested by the Commission on Form MA and Form MA-I, which includes information about any criminal actions, regulatory actions, investigations, terminations, judgments, liens, civil judicial actions, customer complaints, arbitrations and civil litigation, and information identifying where the client may electronically access the municipal advisor's most recent Form MA and each most recent Form MA-I filed with the Commission;

(iv) the date of the last material change to a legal or disciplinary event disclosure on any Form MA or Form MA-I filed with the Commission by the municipal advisor;

~~(iv)~~(v) the scope of the municipal advisory activities to be performed and any limitations on the scope of the engagement;

~~(v) in the case of municipal advisory activities relating to a new issue or reoffering of municipal securities, the specific undertakings, if any, requested by the client to be performed by the municipal advisor with respect to the preparation and finalization of an official statement or similar disclosure document; and~~

(vi) the date, triggering event, or means for the termination of the municipal advisory relationship, or, if none, a statement that there is none~~.~~; and

(vii) any terms relating to withdrawal from the municipal advisory relationship.

During the term of the municipal advisory relationship, the writing must be promptly amended or supplemented to reflect any material changes ~~in~~ or additions ~~to the terms or information required by section (b) or this section (c)~~, and the revised writing must be promptly delivered to the client~~, provided that this requirement applies with respect to subsection(c)(ii) of this rule only if the change in the amount of reasonably expected compensation is material~~. This amendment and supplementation requirement applies to any changes and additions that are discovered, or should have been discovered, based on the exercise of reasonable diligence by the municipal advisor.

(d) *Recommendations and Review of Recommendations of Other Parties*. ~~A~~ If a municipal advisor ~~must not recommend that its municipal entity or obligated person client enter into any~~makes a recommendation of a municipal securities transaction or municipal financial product~~ unless~~, or if the ~~advisor has a reasonable basis for believing~~review of a recommendation of another party is requested by the municipal entity or obligated person client and within the scope of the engagement, the municipal advisor must determine, based on the information obtained through the reasonable diligence of ~~the~~such advisor, ~~that the~~whether a municipal securities transaction or municipal financial product is suitable for the client. ~~-~~In addition, the municipal advisor must ~~discuss with its~~inform the client of:

(i) the municipal advisor's evaluation of the material risks, potential benefits, structure, and other characteristics of the recommended municipal securities transaction or municipal financial product;

(ii) the basis upon which the municipal advisor reasonably believes that the recommended municipal securities transaction or municipal financial product is, or is not, suitable for the client; and

(iii) whether the municipal advisor has investigated or considered other reasonably feasible alternatives to the recommended municipal securities transaction or municipal financial product that might also or alternatively serve the client's objectives.

~~With respect to a client that is a municipal entity, a municipal advisor may only recommend a municipal securities transaction or municipal financial product that is in the client's best interest.~~

~~(e) *Review of Recommendations of Other Parties.* When requested to do so by its municipal entity or obligated person client and within the scope of its engagement, a municipal advisor must undertake a thorough review of any recommendation made by any third party regarding a municipal securities transaction or municipal financial product. In addition, the municipal advisor must discuss with its client:~~

~~(i) the municipal advisor's evaluation of the material risks, potential benefits, structure, and other characteristics of the recommended municipal securities transaction or municipal financial product;~~

~~(ii) whether the municipal advisor reasonably believes that the recommended municipal securities transaction or municipal financial product is suitable for the client, and the basis for such belief; and~~

~~(iii) whether the municipal advisor has investigated or considered other reasonably feasible alternatives to the recommended municipal securities transaction or municipal financial product that might also or alternatively serve the client's objectives.~~

~~(f) *Principal Transactions.* Except for an activity that is expressly permitted under Rule G-23, a municipal advisor, and any affiliate of a municipal advisor, is prohibited from engaging in any transaction, in a principal capacity, to which a municipal entity or obligated person client of the municipal advisor is a counterparty.~~

~~(g)~~(e) *Specified Prohibitions.*

(i) A municipal advisor is prohibited from:

~~(i)~~(A) receiving compensation that is excessive in relation to the municipal advisory activities actually performed;

~~(ii)~~(B) delivering an invoice for fees or expenses for municipal advisory activities that do not accurately reflect the activities actually performed or the personnel that actually performed those services;

~~(iii)~~(C) making any representation or the submission of any information about the capacity, resources or knowledge of the municipal advisor, in response to requests for proposals or

qualifications or in oral presentations to a client or prospective client, for the purpose of obtaining or retaining municipal advisory business that the advisor knows or should know is materially false or misleading;

(iv)(D) making, or participating in, any fee-splitting arrangements with underwriters on any municipal securities transaction for which it is acting as municipal advisor, and any undisclosed fee-splitting arrangements with providers of investments or services to a municipal entity or obligated person client of the municipal advisor; and

(v)(E) making payments for the purpose of obtaining or retaining municipal advisory business other than reasonable fees paid to another municipal advisor registered as such with the Commission and the Board for a solicitation of a municipal entity or obligated person as described in Section 15B(e)(9) of the Act.

(ii) A municipal advisor to a municipal entity client, and any affiliate of such municipal advisor, is prohibited from engaging in a principal transaction directly related to the same municipal securities transaction or municipal financial product as to which the municipal advisor is providing advice.

(h)(f) *Definitions*.

(i) "Engaging in a principal transaction" shall mean, for purposes of this rule, when acting as principal for one's own account, selling to or purchasing from the municipal entity client any security or entering into any derivative, guaranteed investment contract, or other similar financial product with the municipal entity client.

(ii) "Advice" shall, for purposes of this rule, have the same meaning as in Section 15B(e)(4)(A)(i) of the Act, 17 CFR 240.15Ba1-1(d)(1)(ii) and theother rules and regulations thereunder.

(ii)(iii) "Affiliate of the municipal advisor" shall mean, for purposes of this rule, any person directly or indirectly controlling, controlled by, or under common control with such municipal advisor.

(iii)(iv) "Municipal advisor" shall, for purposes of this rule, have the same meaning as in Section 15B(e)(4) of the Act and the, 17 CFR 240.15Ba1-1(d)(1)-(4) and other rules and regulations thereunder; provided that it shall exclude a person that is otherwise a municipal advisor solely with respect to either activities within the meaning of Section 15B(e)(4)(A)(ii) or any solicitation of a municipal entity or obligated person within the meaning of Section 15B(e)(9) of the Act.

(iv)(v) "Municipal advisory activities" shall, for purposes of this rule, have the same meaning as themean those activities specified in Section 15B(e)(4)(A) of the Act and the rules and regulations thereunder, provided that they shall exclude the activities within the meaning of Section 15B(e)(4)(A)(ii) of the Act and the rules and regulations thereunder and any solicitation ofwould cause a person to be a municipal entity or obligated person within the meaning of Section 15B(e)(9) of the Act and the rules and regulations thereunderadvisor as defined in section (f)(iv) hereof.

(v)(vi) A "municipal advisory relationship" shall, for purposes of this rule, be deemed to exist when a municipal advisor engages in or enters into an agreement to engage in municipal advisory activities for or on behalf of a municipal entity or obligated person client. The municipal advisory relationship shall be deemed to have ended on the date which is the earlier of (i) the date on which the municipal advisory relationship has terminated pursuant to the terms of the documentation of the municipal advisory relationship required in section (c) hereof or (ii) the date on which the municipal advisor withdraws from the municipal advisory relationship.

(vi) "Municipal advisory business" shall mean, for purposes of this rule, the provision of advice to or on behalf of a municipal entity or an obligated person with respect to the issuance of municipal securities or municipal financial products by a municipal advisor whether for compensation or otherwise.

(vii) "Municipal entity" shall, for purposes of this rule, have the same meaning as in Section 15B(e)(8) of the Act, 17 CFR 240.15Ba1-1(g) and theother rules and regulations thereunder.

(viii) "Obligated person" shall, for purposes of this rule, have the same meaning as in Section 15B(e)(10) of the Act, 17 CFR 240.15Ba1-1(k) and theother rules and regulations thereunder.

(ix) "Official statement" shall, for purposes of this rule, have the same meaning as in Rule G-32(d)(vii).

---Supplementary Material:

.01 Duty of Care. Municipal advisors must exercise due care in performing their municipal advisory activities. The duty of care includes, but is not limited to, the obligations discussed in this section. A municipal advisor must possess the degree of knowledge and expertise needed to provide the municipal entity or obligated person client with informed advice. A municipal advisor also must make a reasonable inquiry as to the facts that are relevant to a client's determination as to whether to proceed with a course of action or that form the basis for any advice provided to the client. A municipal advisor that is engaged by a client in connection with either an issuance of municipal securities or a municipal financial product that is related to an issuance of municipal securities must also undertake a thorough review of the official statement for that issue, unless otherwise directed by the client and documented under subsection (c)(iv) of this rule. A municipal advisor must undertake a reasonable investigation to determine that it is not basing any recommendation on materially inaccurate or incomplete information. Among other matters, a municipal advisor must have a reasonable basis for:

(a) any advice provided to or on behalf of a client;

(b) any representations made in a certificate that it signs that will be reasonably foreseeably relied upon by the client, any other party involved in the municipal securities transaction or municipal financial product, or investors in the municipal entity client's securities or securities secured by payments from an obligated person client; and

(c) any information provided to the client or other parties involved in the municipal securities transaction ~~when participating~~ in connection with the preparation of an official statement for any issue of municipal securities with respect to which the advisor is advising.

.02 Duty of Loyalty. Municipal advisors must fulfill a duty of loyalty in performing their municipal advisory activities for municipal entity clients. The duty of loyalty includes, but is not limited to, the obligations discussed in this section. A municipal advisor must deal honestly and with the utmost good faith with a municipal entity client and act in the client's best interests without regard to the financial or other interests of the municipal advisor. A municipal advisor to a municipal entity client must either eliminate or provide full and fair disclosure to the client about each of its material conflicts of interest. A municipal advisor must ~~investigate or consider other reasonably feasible alternatives to any recommended~~not engage in municipal ~~securities transaction or municipal financial product~~advisory activities with a municipal entity client if it cannot manage or mitigate its conflicts in a manner that ~~might also or alternatively serve~~will permit it to act in the municipal ~~entity client's objectives.~~entity's best interests.

.03 Action Independent of or Contrary to Advice. If a municipal entity or obligated person client of a municipal advisor elects a course of action that is independent of or contrary to advice provided by the advisor, the advisor is not required on that basis to disengage from the municipal advisory relationship.

.04 Limitations on the Scope of the Engagement. Nothing contained in this rule shall be construed to permit the municipal advisor to alter the standards of conduct or impose limitations on any of the duties prescribed herein. If requested or consented to by the municipal entity or obligated person client, however, a municipal advisor may limit the scope of the municipal advisory ~~relationship~~activities to certain specified activities or services. If the municipal advisor engages in a course of conduct that is inconsistent with any such agreed upon limitations, it may result in negating the effectiveness of such limitations.

.05 Conflicts of Interest. Disclosures of conflicts of interest by a municipal advisor to its municipal entity or obligated person client must be sufficiently detailed to inform the client of the nature, implications and potential consequences of each conflict. Such disclosures also must include an explanation of how the advisor addresses or intends to manage or mitigate each conflict.

.06 Inadvertent Advice. A municipal advisor is not required to comply with sections (b) and (c) of this rule if the advisor meets all of the following requirements. In the event that a municipal advisor inadvertently engages in municipal advisory activities for or on behalf of a municipal entity or obligated person and does not intend to continue the municipal advisory activities or enter into a municipal advisory relationship, the municipal advisor must, as promptly as possible, provide a document to such municipal entity or obligated person that is dated and includes:

(A) a disclaimer that the advisor did not intend to provide advice and that, effective immediately, it has ceased engaging in municipal advisory activities;

(B) a notification that such municipal entity or obligated person should be aware that the disclosure of material conflicts of interest and other information required by section (b) of this rule has not been provided;

(C) a representation by the advisor that it, in good faith, has undertaken reasonable efforts to identify the advice that was inadvertently provided; and

(D) a request that the municipal entity or obligated person acknowledge receipt.

A municipal advisor utilizing this alternative must promptly conduct a review of its written supervisory and compliance policies and procedures to ensure they are reasonably designed to prevent the provision of inadvertent advice to municipal entities and obligated persons.

.07 Applicability of State or Other Laws and Rules. Municipal advisors may be subject to fiduciary or other duties under state or other laws. Nothing contained in this rule shall be deemed to supersede any more restrictive provision of state or other laws applicable to the activities of municipal advisors. In addition, the specific prohibition in section (e)(ii) of this rule shall not apply to an acquisition as principal, either alone or as a participant in a syndicate or other similar account formed for the purpose of purchasing, directly or indirectly, from an issuer all or any portion of an issuance of municipal securities, provided that the municipal advisor complies with all of the provisions of Rule G-23.

~~.07~~.08 Disclosure to Investors. If all or a portion of a document prepared by a municipal advisor or any of its affiliates is included in an official statement for any issue of municipal securities by or on behalf of its municipal entity or obligated person client, the municipal advisor must provide written disclosure to investors, which disclosure may be provided in the official statement, of any affiliation that meets the criteria of subsection ~~(b)(ii)~~ (b)(i)(B) of this rule. This disclosure requirement shall be deemed satisfied if the relevant affiliate provides the required written disclosure to investors.

~~.08~~.09 Suitability. A determination of whether a municipal securities transaction or municipal financial product is suitable must be based on the client's financial situation and needs, objectives, tax status, risk tolerance, liquidity needs, experience with municipal securities transactions or municipal financial products generally or of the type and complexity being recommended, financial capacity to withstand changes in market conditions during the term of the municipal financial product or the period that municipal securities to be issued in the municipal securities transaction are reasonably expected to be outstanding and any other material information known by the municipal advisor about the client and the municipal securities transaction or municipal financial product, after reasonable inquiry.

~~.09~~.10 Know Your Client. A municipal advisor must use reasonable diligence, in regard to the maintenance of the municipal advisory relationship, to know and retain the essential facts concerning the client and concerning the authority of each person acting on behalf of such client. The facts "essential" to "knowing a client" include those required to:

(a) effectively service the municipal advisory relationship with the client;

(b) act in accordance with any special directions from the client;

(c) understand the authority of each person acting on behalf of the client; and

(d) comply with applicable laws, regulations and rules.

~~.10~~**.11 Excessive Compensation.** Depending on the specific facts and circumstances of the engagement, a municipal advisor's compensation may be so disproportionate to the nature of the municipal advisory services performed as to constitute an unfair practice in violation of Rule G-17. Among the factors relevant to whether a municipal advisor's compensation is disproportionate to the nature of the municipal advisory services performed are the municipal advisor's expertise, the complexity of the municipal securities transaction or municipal financial product, whether the fee is contingent upon the closing of the municipal securities transaction or municipal financial product, the length of time spent on the engagement and whether the municipal advisor is paying any other relevant costs related to the municipal securities transaction or municipal financial product.

.12 529 College Savings Plans and Other Municipal Fund Securities. This rule applies equally to municipal advisors to sponsors or trustees of 529 college savings plans and other municipal fund securities. All references in this rule to an "official statement" include the plan disclosure document for a 529 college savings plan and the investment circular or information statement for a local government investment pool.

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Rule G-8: Books and Records to be Made by Brokers, Dealers, Municipal Securities Dealers, and Municipal Advisors[15]

(a) - (g) No change.

(h) *Municipal Advisor Records*. Every municipal advisor that is registered or required to be registered under Section 15B of the Act and the rules and regulations thereunder shall make and keep current the following books and records:

(i) ~~*General Business Records.* All books and records described in Rule 15Ba1-8(a)(1)-(8) under the Act.~~Reserved.

(ii) Reserved.

(iii) Reserved.

[15] The MSRB has multiple rulemaking initiatives currently pending that would revise Rules G-8 and G-9. The revised draft amendments to Rules G-8 and G-9 reflect the substance that is related to revised draft Rule G-42, and technical or non-substantive changes will be made as necessary depending on the progress of this and the other rulemaking initiatives.

(iv) *Records Concerning Duties of Non-Solicitor Municipal Advisors pursuant to Rule G-42.*

(A) A copy of any document created by a municipal advisor that was material to its review of a recommendation by another party or that memorializes the basis for any conclusions as to suitability; and

(B) Unless included in the official statement for an issue of municipal securities, a copy of any disclosure provided by the municipal advisor or any affiliate of the municipal advisor to investors, as required by the provisions of Rule G-42 Supplementary Material 08.

(v) Reserved.

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Rule G-9: Preservation of Records

(a) - (g) No change.

(h) *Municipal Advisor Records*. Every municipal advisor shall preserve the books and records described in Rule G-8(h) for a period of not less than five years.