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Required fields are shown with yellow backgrounds and asterisks.

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No.* SR - 2011 - * 09
Amendment No. (req. for Amendments *) 1

Proposed Rule Change by Municipal Securities Rulemaking Board

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * ☐ Amendment * ☒ Withdrawal ☐

Section 19(b)(2) * ☒ Section 19(b)(3)(A) * ☐ Section 19(b)(3)(B) * ☐

Pilot ☐

Extension of Time Period for Commission Action * ☐

Date Expires *

Rule

☐ 19b-4(f)(1) ☐ 19b-4(f)(2) ☐ 19b-4(f)(3) ☐ 19b-4(f)(4) ☐ 19b-4(f)(5) ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters, required when Initial is checked *).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name * Margaret Last Name * Henry

Title * General Counsel, Market Regulation

E-mail * phenry@msrb.org

Telephone * (703) 797-6600 Fax (703) 797-6700

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

Municipal Securities Rulemaking Board

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 11/03/2011

By Ronald W. Smith
(Name *)

Corporate Secretary
(Title *)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Ronald Smith, rsmith@msrb.org

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information (required)

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change (required)

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Add Remove View

Exhibit Sent As Paper Document ☐

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Exhibit Sent As Paper Document ☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

The Municipal Securities Rulemaking Board (the "MSRB" or "Board") is filing with the Securities and Exchange Commission (the "SEC" or "Commission") this partial amendment ("Amendment No. 1") to File No. SR-MSRB-2011-09, which was filed with the Commission on August 22, 2011 (the "original proposed rule change" and, as amended by Amendment No. 1, the "proposed rule change"). The proposed rule change consists of a proposed interpretive notice (the "Notice") concerning the application of MSRB Rule G-17 (on conduct of municipal securities and municipal advisory activities) to underwriters of municipal securities.

Amendment No. 1 would require an underwriter to provide an issuer of municipal securities with disclosure about the role of the underwriter, its compensation, and actual or potential material conflicts of interest. As described in more detail below, Amendment No. 1 would also address the required timing of such disclosures and the recipient, as well as written acknowledgement of such disclosures. Amendment No. 1 would also prohibit an underwriter from recommending that the issuer not retain a municipal advisor.

Amendment No. 1 would provide that any disclosures required to be made with respect to routine financings would be based on the underwriter's "reasonable belief" that issuer personnel lack knowledge or experience with such structures and would be linked to whether the underwriter has recommended such financings. Disclosures concerning swaps would also be required to be made only as to the swaps recommended by underwriters, not those recommended by other parties.

Under Amendment No. 1, the requirement of the Notice to disclose the risks of a complex municipal securities financing would be limited to those material financial risks that are known to the underwriter and reasonably foreseeable at the time of the disclosure. Required disclosures concerning the characteristics of a financing similarly would be limited to material financial characteristics.

In addition, the MSRB discusses the responses to comment letters received by the Commission in response to the notice for comment on the original proposed rule change published in the Federal Register.[1]

Amendment to Text of Original Proposed Rule Change

The changes made by Amendment No. 1 to the original proposed rule change are indicated below: [2]

* * * * * * * * *

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1 See SEC Release No. 34-65263, File No. SR-MSRB-2011-09 (September 6, 2011).

2 Underlining indicates additions and brackets indicate deletions made by Amendment No. 1 to the original proposed rule change.

INTERPRETIVE [GUIDANCE] NOTICE CONCERNING THE APPLICATION OF MSRB RULE G-17 TO UNDERWRITERS OF MUNICIPAL SECURITIES

Under Rule G-17 of the Municipal Securities Rulemaking Board (the "MSRB"), brokers, dealers, and municipal securities dealers ("dealers") must, in the conduct of their municipal securities activities, deal fairly with all persons and must not engage in any deceptive, dishonest, or unfair practice. This rule is most often cited in connection with duties owed by dealers to investors; however, it also applies to their interactions with other market participants, including municipal entities[.][1] such as states and their political subdivisions that are issuers of municipal securities ("issuers").

The MSRB has previously observed that Rule G-17 requires dealers to deal fairly with issuers in connection with the underwriting of their municipal securities.[2] More recently, with the passage of the Dodd-Frank Act,[3] the MSRB was expressly directed by Congress to protect municipal entities. Accordingly, the MSRB is providing additional interpretive guidance that addresses how Rule G-17 applies to dealers acting in the capacity of underwriters in the municipal securities transactions described below. Except where a competitive underwriting is specifically mentioned, this notice applies to negotiated underwritings only. Furthermore, it does not apply to selling group members.

The examples discussed in this notice are illustrative only and are not meant to encompass all obligations of dealers to municipal entities under Rule G-17. The notice also does not address a dealer's duties when the dealer is serving as an advisor to a municipal entity[or obligated person]. Furthermore, when municipal entities are customers[4] of dealers they are subject to the same protections under MSRB rules, including Rule G-17, that apply to other customers.[5] The MSRB notes that an underwriter has a duty of fair dealing to investors in addition to its duty of fair dealing to issuers. An underwriter also has a duty to comply with other MSRB rules as well as other federal and state securities laws.

Basic Fair Dealing Principle

As noted above, Rule G-17 precludes a dealer, in the conduct of its municipal securities activities, from engaging in any deceptive, dishonest, or unfair practice with any person, including an issuer of municipal securities. The rule contains an anti-fraud prohibition. Thus, an underwriter must not misrepresent or omit the facts, risks, potential benefits, or other material information about municipal securities activities undertaken with a municipal issuer. However, Rule G-17 does not merely prohibit deceptive conduct on the part of the dealer. It also establishes a general duty of a dealer to deal fairly with all persons (including, but not limited to, issuers of municipal securities), even in the absence of fraud.

Role of the Underwriter/Conflicts of Interest

In a negotiated underwriting, the underwriter's Rule G-17 duty to deal fairly with an issuer of municipal securities requires the underwriter to make certain disclosures to the issuer to

clarify its role in an issuance of municipal securities and its actual or potential material conflicts of interest with respect to such issuance.

Disclosures Concerning the Underwriter's Role. The underwriter must disclose to the issuer that:

(i) Municipal Securities Rulemaking Board Rule G-17 requires an underwriter to deal fairly at all times with both municipal issuers and investors;

(ii) the underwriter's primary role is to purchase securities with a view to distribution in an arm's-length commercial transaction with the issuer and it has financial and other interests that differ from those of the issuer;

(iii) unlike a municipal advisor, the underwriter does not have a fiduciary duty to the issuer under the federal securities laws and is, therefore, not required by federal law to act in the best interests of the issuer without regard to its own financial or other interests;

(iv) the underwriter has a duty to purchase securities from the issuer at a fair and reasonable price, but must balance that duty with its duty to sell municipal securities to investors at prices that are fair and reasonable; and

(v) the underwriter will review the official statement for the issuer's securities in accordance with, and as part of, its responsibilities to investors under the federal securities laws, as applied to the facts and circumstances of the transaction.

The underwriter also must not recommend that the issuer not retain a municipal advisor.

Disclosure Concerning the Underwriter's Compensation. The underwriter must disclose to the issuer whether its underwriting compensation will be contingent on the closing of a transaction. It must also disclose that compensation that is contingent on the closing of a transaction or the size of a transaction presents a conflict of interest, because it may cause the underwriter to recommend a transaction that it is unnecessary or to recommend that the size of the transaction be larger than is necessary.

Other Conflicts Disclosures. The underwriter must also disclose other potential or actual material conflicts of interest, including, but not limited to, the following:

(i) any payments described below under "Conflicts of Interest/ Payments to or from Third Parties";

(ii) any arrangements described below under "Conflicts of Interest/Profit-Sharing with Investors";

(iii) the credit default swap disclosures described below under "Conflicts of Interest/Credit Default Swaps"; and

(iv) any incentives for the underwriter to recommend a complex municipal securities financing and other associated conflicts of interest (as described below under "Required Disclosures to Issuer").

Disclosures concerning the role of the underwriter and the underwriter's compensation may be made by a syndicate manager on behalf of other syndicate members. Other conflicts disclosures must be made by the particular underwriters subject to such conflicts.

Timing and Manner of Disclosures. All of the foregoing disclosures must be made in writing to an official of the issuer that the underwriter reasonably believes has the authority to bind the issuer by contract with the underwriter and that, to the knowledge of the underwriter, is not a party to a disclosed conflict. Disclosures must be made in a manner designed to make clear to such official the subject matter of such disclosures and their implications for the issuer. The disclosure concerning the arm's-length nature of the underwriter-issuer relationship must be made in the earliest stages of the underwriter's relationship with the issuer with respect to an issue (e.g., in a response to a request for proposals or in promotional materials provided to an issuer). Other disclosures concerning the role of the underwriter and the underwriter's compensation generally must be made when the underwriter is engaged to perform underwriting services (e.g., in an engagement letter), not solely in a bond purchase agreement. Other conflicts disclosures must be made at the same time, except with regard to conflicts discovered or arising after the underwriter has been engaged. For example, a conflict may not be present until an underwriter has recommended a particular financing. In that case, the disclosure must be provided in sufficient time before the execution of a contract with the underwriter to allow the official to evaluate the recommendation, as described below under "Required Disclosures to Issuers."

Acknowledgement of Disclosures. The underwriter must attempt to receive written acknowledgement (other than by automatic e-mail receipt) by the official of the issuer of receipt of the foregoing disclosures. If the official of the issuer agrees to proceed with the underwriting engagement after receipt of the disclosures but will not provide written acknowledgement of receipt, the underwriter may proceed with the engagement after documenting with specificity why it was unable to obtain such written acknowledgement.

Representations to Issuers

All representations made by underwriters to issuers of municipal securities in connection with municipal securities underwritings, whether written or oral, must be truthful and accurate and must not misrepresent or omit material facts. Underwriters must have a reasonable basis for the representations and other material information contained in documents they prepare and must refrain from including representations or other information they know or should know is inaccurate or misleading. For example, in connection with a certificate signed by the underwriter that will be relied upon by the issuer or other relevant parties to an underwriting (e.g., an issue price certificate), the dealer must have a reasonable basis for the representations and other material information contained therein. In addition, an underwriter's response to an issuer's

request for proposals or qualifications must fairly and accurately describe the underwriter's capacity, resources, and knowledge to perform the proposed underwriting as of the time the proposal is submitted and must not contain any representations or other material information about such capacity, resources, or knowledge that the underwriter knows or should know to be inaccurate or misleading. Matters not within the personal knowledge of those preparing the response (e.g., pending litigation) must be confirmed by those with knowledge of the subject matter. An underwriter must not represent that it has the requisite knowledge or expertise with respect to a particular financing if the personnel that it intends to work on the financing do not have the requisite knowledge or expertise.

Required Disclosures to Issuers

Many municipal securities are issued using financing structures that are routine and well understood by the typical municipal market professional, including most issuer personnel that have the lead responsibilities in connection with the issuance of municipal securities. For example, absent unusual circumstances or features, the typical fixed rate offering may be presumed to be well understood. Nevertheless, in the case of issuer personnel that the underwriter reasonably believes lack knowledge or experience with such structures, the underwriter must provide disclosures on the material aspects of such structures that it recommends.

However, in some cases, issuer personnel responsible for the issuance of municipal securities would not be well positioned to fully understand or assess the implications of a financing in its totality, because the financing is structured in a unique, atypical, or otherwise complex manner (a "complex municipal securities financing").[6] Examples of complex municipal securities financings include variable rate demand obligations ("VRDOs") and financings involving derivatives (such as swaps). An underwriter in a negotiated offering that recommends a complex municipal securities financing to an issuer has an obligation under Rule G-17 to make more particularized disclosures than those that may be required in the case of routine financing structures. The underwriter must disclose [all] the material [risks and] financial characteristics of the complex municipal securities financing, as well as the material financial risks of the financing that are known to the underwriter and reasonably foreseeable at the time of the disclosure.[7] It must also disclose any incentives for the underwriter to recommend the financing and other associated conflicts of interest.[8] Such disclosures must be made in a fair and balanced manner based on principles of fair dealing and good faith.

The level of disclosure required may vary according to the issuer's knowledge or experience with the proposed financing structure or similar structures, capability of evaluating the risks of the recommended financing, and financial ability to bear the risks of the recommended financing, in each case based on the reasonable belief of the underwriter.[9] In all events, the underwriter must disclose any incentives for the underwriter to recommend the complex municipal securities financing and other associated conflicts of interest.

The disclosures described in this section of this notice must be made in writing to an official of the issuer whom the underwriter reasonably believes has the authority to bind the

issuer by contract with the underwriter (i) in sufficient time before the execution of a contract with the underwriter to allow the official to evaluate the recommendation and (ii) in a manner designed to make clear to such official the subject matter of such disclosures and their implications for the issuer. The disclosures concerning a complex municipal securities financing must address the specific elements of the financing, rather than being general in nature. If the underwriter does not reasonably believe that the official to whom the disclosures are addressed is capable of independently evaluating the disclosures, the underwriter must make additional efforts reasonably designed to inform the official or its employees or agent.

Underwriter Duties in Connection with Issuer Disclosure Documents

Underwriters often play an important role in assisting issuers in the preparation of disclosure documents, such as preliminary official statements and official statements. [10] These documents are critical to the municipal securities transaction, in that investors rely on the representations contained in such documents in making their investment decisions. Moreover, investment professionals, such as municipal securities analysts and ratings services, rely on the representations in forming an opinion regarding the credit. A dealer's duty to have a reasonable basis for the representations it makes, and other material information it provides, to an issuer and to ensure that such representations and information are accurate and not misleading, as described above, extends to representations and information provided by the underwriter in connection with the preparation by the issuer of its disclosure documents (e.g., cash flows).

Underwriter Compensation and New Issue Pricing

Excessive Compensation. An underwriter's compensation for a new issue (including both direct compensation paid by the issuer and other separate payments, values, or credits received by the underwriter from the issuer or any other party in connection with the underwriting), in certain cases and depending upon the specific facts and circumstances of the offering, may be so disproportionate to the nature of the underwriting and related services performed as to constitute an unfair practice with regard to the issuer that it is a violation of Rule G-17. Among the factors relevant to whether an underwriter's compensation is disproportionate to the nature of the underwriting and related services performed, are the credit quality of the issue, the size of the issue, market conditions, the length of time spent structuring the issue, and whether the underwriter is paying the fee of the underwriter's counsel or any other relevant costs related to the financing.

Fair Pricing. The duty of fair dealing under Rule G-17 includes an implied representation that the price an underwriter pays to an issuer is fair and reasonable, taking into consideration all relevant factors, including the best judgment of the underwriter as to the fair market value of the issue at the time it is priced. [11] In general, a dealer purchasing bonds in a competitive underwriting for which the issuer may reject any and all bids will be deemed to have satisfied its duty of fairness to the issuer with respect to the purchase price of the issue as long as the dealer's bid is a bona fide bid (as defined in Rule G-13)[12] that is based on the dealer's best judgment of the fair market value of the securities that are the subject of the bid. In a negotiated underwriting, the underwriter has a duty under Rule G-17 to negotiate in good faith with the

issuer. This duty includes the obligation of the dealer to ensure the accuracy of representations made during the course of such negotiations, including representations regarding the price negotiated and the nature of investor demand for the securities (e.g., the status of the order period and the order book). If, for example, the dealer represents to the issuer that it is providing the "best" market price available on the new issue, or that it will exert its best efforts to obtain the "most favorable" pricing, the dealer may violate Rule G-17 if its actions are inconsistent with such representations. [13]

Conflicts of Interest

Payments to or from Third Parties. In certain cases, compensation received by the underwriter from third parties, such as the providers of derivatives and investments (including affiliates of the underwriter), may color the underwriter's judgment and cause it to recommend products, structures, and pricing levels to an issuer when it would not have done so absent such payments. The MSRB views the failure of an underwriter to disclose to the issuer the existence of payments, values, or credits received by the underwriter in connection with its underwriting of the new issue from parties other than the issuer, and payments made by the underwriter in connection with such new issue to parties other than the issuer (in either case including payments, values, or credits that relate directly or indirectly to collateral transactions integrally related to the issue being underwritten), to be a violation of the underwriter's obligation to the issuer under Rule G-17.[14] For example, it would be a violation of Rule G-17 for an underwriter to compensate an undisclosed third party in order to secure municipal securities business. Similarly, it would be a violation of Rule G-17 for an underwriter to receive undisclosed compensation from a third party in exchange for recommending that third party's services or product to an issuer, including business related to municipal securities derivative transactions. This notice does not require that the amount of such third-party payments be disclosed. [The underwriter must disclose to the issuer the amount paid or received, the purpose for which such payment was made and the name of the party making or receiving such payment.] The underwriter must also disclose to the issuer whether it has entered into [the details of] any third-party arrangements for the marketing of the issuer's securities.

Profit-Sharing with Investors. Arrangements between the underwriter and an investor purchasing new issue securities from the underwriter (including purchases that are contingent upon the delivery by the issuer to the underwriter of the securities) according to which profits realized from the resale by such investor of the securities are directly or indirectly split or otherwise shared with the underwriter also would, depending on the facts and circumstances (including in particular if such resale occurs reasonably close in time to the original sale by the underwriter to the investor), constitute a violation of the underwriter's fair dealing obligation under Rule G-17. Such arrangements could also constitute a violation of Rule G-25(c), which precludes a dealer from sharing, directly or indirectly, in the profits or losses of a transaction in municipal securities with or for a customer.

Credit Default Swaps. The issuance or purchase by a dealer of credit default swaps for which the reference is the issuer for which the dealer is serving as underwriter, or an obligation of that issuer, may pose a conflict of interest, because trading in such municipal credit default

swaps has the potential to affect the pricing of the underlying reference obligations, as well as the pricing of other obligations brought to market by that issuer. Rule G-17 requires, therefore, that a dealer disclose the fact that it engages in such activities [disclose that] to the issuers for which it serves as underwriter. Activities with regard to [Trades in] credit default swaps based on baskets or indexes of municipal issuers that include the issuer or its obligation(s) need not be disclosed, unless the issuer or its obligation(s) represents more than 2% of the total notional amount of the credit default swap or the underwriter otherwise caused the issuer or its obligation(s) to be included in the basket or index.

Retail Order Periods

Rule G-17 requires an underwriter that has agreed to underwrite a transaction with a retail order period to, in fact, honor such agreement. [15] A dealer that wishes to allocate securities in a manner that is inconsistent with an issuer's requirements must not do so without the issuer's consent. In addition, Rule G-17 requires an underwriter that has agreed to underwrite a transaction with a retail order period to take reasonable measures to ensure that retail clients are bona fide. An underwriter that knowingly accepts an order that has been framed as a retail order when it is not (e.g., a number of small orders placed by an institutional investor that would otherwise not qualify as a retail customer) would violate Rule G-17 if its actions are inconsistent with the issuer's expectations regarding retail orders. In addition, a dealer that places an order that is framed as a qualifying retail order but in fact represents an order that does not meet the qualification requirements to be treated as a retail order (e.g., an order by a retail dealer without "going away" orders [16] from retail customers, when such orders are not within the issuer's definition of "retail") violates its Rule G-17 duty of fair dealing. The MSRB will continue to review activities relating to retail order periods to ensure that they are conducted in a fair and orderly manner consistent with the intent of the issuer and the MSRB's investor protection mandate.

Dealer Payments to Issuer Personnel

Dealers are reminded of the application of MSRB Rule G-20, on gifts, gratuities, and non-cash compensation, and Rule G-17, in connection with certain payments made to, and expenses reimbursed for, issuer personnel during the municipal bond issuance process. [17] These rules are designed to avoid conflicts of interest and to promote fair practices in the municipal securities market.

Dealers should consider carefully whether payments they make in regard to expenses of issuer personnel in the course of the bond issuance process, including in particular, but not limited to, payments for which dealers seek reimbursement from bond proceeds or issuers, comport with the requirements of Rule G-20. For example, a dealer acting as a financial advisor or underwriter may violate Rule G-20 by paying for excessive or lavish travel, meal, lodging and entertainment expenses in connection with an offering (such as may be incurred for rating agency trips, bond closing dinners, and other functions) that inure to the personal benefit of issuer personnel and that exceed the limits or otherwise violate the requirements of the rule. [18]

_____ __, 2011

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[1] The term "municipal entity" is defined by Section 15B(e)(8) of the Securities Exchange Act (the "Exchange Act") to mean: "any State, political subdivision of a State, or municipal corporate instrumentality of a State, including—(A) any agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality; (B) any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and (C) any other issuer of municipal securities."

[2] See Reminder Notice on Fair Practice Duties to Issuers of Municipal Securities, MSRB Notice 2009-54 (September 29, 2009); Rule G-17 Interpretive Letter – Purchase of new issue from issuer, MSRB interpretation of December 1, 1997, reprinted in MSRB Rule Book ("1997 Interpretation").

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 § 975, 124 Stat. 1376 (2010).

[4] MSRB Rule D-9 defines the term "customer" as follows: "Except as otherwise specifically provided by rule of the Board, the term "Customer" shall mean any person other than a broker, dealer, or municipal securities dealer acting in its capacity as such or an issuer in transactions involving the sale by the issuer of a new issue of its securities."

[5] See MSRB Reminds Firms of Their Sales Practice and Due Diligence Obligations When Selling Municipal Securities in the Secondary Market, MSRB Notice 2010-37 (September 20, 2010).

[6] If a complex municipal securities financing consists of an otherwise routine financing structure that incorporates a unique, atypical or complex element and the issuer personnel have [has] knowledge or experience with respect to the routine elements of the financing, the disclosure of material risks and characteristics may be limited to those relating to such specific element and any material impact such element may have on other features that would normally be viewed as routine.

[7] For example, an underwriter that recommends a VRDO should inform the issuer of the risk of interest rate fluctuations and material risks of any associated credit or liquidity facilities (e.g., the risk that the issuer might not be able to replace the facility upon its expiration and might be required to repay the facility provider over a short period of time). As an additional example, if the underwriter recommends that the issuer swap the floating rate interest payments on the VRDOs to fixed rate payments under a[n integrally-related] swap[and the underwriter or an affiliate of the underwriter is proposed to be the executing swap dealer], the underwriter must disclose the material financial risks

(including market, credit, operational, and liquidity risks) and material financial characteristics of the **[**integrally-related**]** recommended swap (e.g., the material economic terms of the swap, the material terms relating to the operation of the swap, and the material rights and obligations of the parties during the term of the swap), as well as the material financial risks associated with the VRDO. Such disclosure should be sufficient to allow the issuer to assess the magnitude of its potential exposure as a result of the complex municipal securities financing. The underwriter must also inform the issuer that there may be accounting, legal, and other risks associated with the swap and that the issuer should consult with other professionals concerning such risks. If the underwriter's affiliated swap dealer is proposed to be the executing swap dealer, the underwriter may satisfy its disclosure obligation with respect to the swap if such disclosure has been provided to the issuer by the affiliated swap dealer or the issuer's swap or other financial advisor that is independent of the underwriter and the swap dealer, as long the underwriter has a reasonable basis for belief in the truthfulness and completeness of such disclosure. If the issuer decides to enter into a swap with another dealer, the underwriter is not required to make disclosures with regard to that swap. The MSRB notes that dealers that recommend swaps or security-based swaps to municipal entities may also be subject to rules of the Commodity Futures Trading Commission or those of the Securities and Exchange Commission ("SEC").

[8] For example, a conflict of interest may exist when the underwriter is also the provider of a swap used by an issuer to hedge a municipal securities offering or when the underwriter receives compensation from a swap provider for recommending the swap provider to the issuer. See also "Conflicts of Interest/Payments to or from Third Parties" herein.

[9] Even a financing in which the interest rate is benchmarked to an index that is commonly used in the municipal marketplace (e.g., LIBOR or SIFMA) may be complex to an issuer that does not understand the components of that index or its possible interaction with other indexes.

[10] Underwriters that assist issuers in preparing official statements must remain cognizant of their duties under federal securities laws. With respect to primary offerings of municipal securities, the SEC has noted, "By participating in an offering, an underwriter makes an implied recommendation about the securities." See SEC Rel. No. 34-26100 (Sept. 22, 1988) (proposing Exchange Act Rule 15c2-12) at text following note 70. The SEC has stated that "this recommendation itself implies that the underwriter has a reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offerings." Furthermore, pursuant to SEC Rule 15c2-12(b)(5), an underwriter may not purchase or sell municipal securities in most primary offerings unless the underwriter has reasonably determined that the issuer or an obligated person has entered into a written undertaking to provide certain types of secondary market disclosure and has a reasonable basis for relying on the accuracy of the issuer's ongoing disclosure representations. SEC Rel. No. 34-34961 (Nov. 10, 1994) (adopting continuing disclosure provisions of Exchange Act Rule 15c2-12) at text following note 52.

[11] The MSRB has previously observed that whether an underwriter has dealt fairly with an issuer for purposes of Rule G-17 is dependent upon all of the facts and circumstances of an underwriting and is not dependent solely on the price of the issue. See MSRB Notice 2009-54 and the 1997 Interpretation. See also "Retail Order Periods" herein.

[12] Rule G-13(b)(iii) provides: "For purposes of subparagraph (i), a quotation shall be deemed to represent a "bona fide bid for, or offer of, municipal securities" if the broker, dealer or municipal securities dealer making the quotation is prepared to purchase or sell the security which is the subject of the quotation at the price stated in the quotation and under such conditions, if any, as are specified at the time the quotation is made."

[13] See 1997 Interpretation.

[14] See also "Required Disclosures to Issuers" herein.

[15] See MSRB Interpretation on Priority of Orders for Securities in a Primary Offering under Rule G-17, MSRB interpretation of October 12, 2010, reprinted in MSRB Rule Book. The MSRB also reminds underwriters of previous MSRB guidance on the pricing of securities sold to retail investors. See Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities, MSRB Notice 2009-42 (July 14, 2009).

[16] In general, a "going away" order is an order for new issue securities for which a customer is already conditionally committed. See SEC Release No. 34-62715, File No. SR-MSRB-2009-17 (August 13, 2010).

[17] See MSRB Rule G-20 Interpretation — Dealer Payments in Connection With the Municipal Securities Issuance Process, MSRB interpretation of January 29, 2007, reprinted in MSRB Rule Book.

[18] See In the Matter of RBC Capital Markets Corporation, SEC Rel. No. 34-59439 (Feb. 24, 2009) (settlement in connection with broker-dealer alleged to have violated MSRB Rules G-20 and G-17 for payment of lavish travel and entertainment expenses of city officials and their families associated with rating agency trips, which expenditures were subsequently reimbursed from bond proceeds as costs of issuance); In the Matter of Merchant Capital, L.L.C., SEC Rel. No. 34-60043 (June 4, 2009) (settlement in connection with broker-dealer alleged to have violated MSRB rules for payment of travel and entertainment expenses of family and friends of senior officials of issuer and reimbursement of the expenses from issuers and from proceeds of bond offerings).

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Discussion of Changes Proposed in Amendment No. 1

Amendment No. 1 would clarify that the Notice concerns the duties of underwriters to municipal entity issuers of municipal securities, not obligated persons. It would also clarify that the Notice would not apply to selling group members and that, unless otherwise specified, the Notice would apply only to negotiated underwritings and not to competitive underwritings.

Amendment No. 1 would provide for robust disclosure by an underwriter as to its role, its compensation, and actual or potential material conflicts of interest. The disclosure would build on the disclosure already required by the Rule G-23 interpretive notice approved by the Commission in May of this year.[3] Certain of the required disclosures could be made by a syndicate manager on behalf of other syndicate members. Amendment No. 1 would also prohibit an underwriter from recommending that the issuer not retain a municipal advisor.

The required disclosures would generally be required to be made at the time the underwriter is engaged to provide underwriting services and to be made to an official of the issuer with the power to bind the issuer by contract with the underwriter. The disclosure concerning the arm's-length nature of the underwriter-issuer relationship would continue to be required to be made at the earliest stages of the underwriter-issuer relationship, as required by the Rule G-23 interpretive notice. In the case of disclosures triggered by recommendations as to particular financings, the disclosures would continue to be required to be provided in sufficient time before the execution of a contract with the underwriter to allow the official to evaluate the recommendation. The disclosures required in the amended Notice under "Role of the Underwriter/Conflicts of Interest/ Other Conflicts Disclosures" are not new. They would simply included in the list of required disclosures, so that underwriters reviewing the Notice would only need to look to one place to see all the required conflicts disclosures. The underwriter would be required to attempt to obtain the written acknowledgement of the issuer to the required disclosures and, if the issuer would not provide such acknowledgement, to document that fact.

Any disclosures required to be made with respect to routine financings would be based on the underwriter's "reasonable belief" that issuer personnel lack knowledge or experience with such structures and be linked to whether the underwriter had recommended the routine financing. Disclosures concerning swaps would also be required to be made only as to the swaps recommended by underwriters. If an issuer decided to accept the recommendation of a swap provider other than the underwriter, the underwriter would have no disclosure obligation with regard to that other provider's swap.

Amendment No. 1 would not eliminate any of the disclosures already required of underwriters under the Notice. However, the requirement to disclose the risks of a complex municipal securities financing would be limited to those material financial risks that are known to the underwriter and reasonably foreseeable at the time of the disclosure. Similarly, disclosures concerning the characteristics of a financing would be limited to material financial

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[3] See SEC Release No. 34-64564, File No. SR-MSRB-2011-03 (May 27, 2011).

characteristics. Examples of the material financial characteristics of a swap would be provided. Underwriters would also be required to inform the issuer that there might be accounting, legal, and other risks associated with a swap and that the issuer should consult with other professionals concerning such risks.

Amendment No. 1 would clarify the provisions of the Notice concerning disclosures of third-party payments and credit default swaps by providing that the Notice would require disclosure of the existence of third-party payments, but not the amount, and that particular transactions in credit default swaps would not be required to be disclosed under the Notice. These disclosures would draw the attention of issuers to such payments and credit default swap activity, and the issuers could choose to request more information from the underwriters.

Discussion of Comments Received by the Commission

The Commission received 5 comment letters[4] regarding the original proposed rule change. A summary of the comments and MSRB responses follows.

- **Comment: The required underwriter disclosures and duties would benefit issuers, but they are not sufficient.**

GFOA said that the Notice would "help protect issuers from fraudulent and manipulative acts and practices and provide proper guidance to all market participants so that uncertainties are minimized and all have can have a clear understanding of necessary disclosures between underwriters and issuers." GFOA said that the following requirements would be helpful to issuers:

- an underwriter's representations to issuers must be accurate and not misleading;
- an underwriter's level of disclosure must be tailored according to the knowledge and sophistication of the issuer;
- an underwriter must disclose to the issuer any incentives, conflicts of interest, or third-party payments;
- an underwriter must pay the issuer a fair and reasonable price for its securities;

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[4] The Commission received comments from the Bond Dealers of America ("BDA"); the Government Finance Officers Association ("GFOA"); the National Association of Independent Finance Advisors ("NAIPFA"); the Securities Industry and Financial Markets Association ("SIFMA"); and WM Financial Strategies ("WM Financial"). These comment letters are posted on the Commission's website at http://www.sec.gov/comments/sr-msrb-2011-09/msrb201109.shtml.

- an underwriter must not manipulate retail order periods;
- an underwriter must disclose credit default swap activities concerning the issuer or its securities; and
- disclosures must be made within an adequate time frame, prior to the time of the execution of the bond purchase agreement.[5]

However, GFOA said that the Notice should impose the following additional requirements on underwriters:

- disclosure of pending litigation affecting the underwriter's municipal securities business;
- disclosure if any experts of the firm that the issuer may have relied upon in selecting the particular underwriter for the transaction have departed from the firm;
- disclosure of additional information about the risks associated with the transaction, including a comparison of different types of financings that may be applicable for the issuer's particular situation;
- a statement by the underwriter that the issuer does not have a fiduciary responsibility to the issuer and that the issuer may choose to engage the services of an independent financial advisor to represent the issuer's interests in the transaction;
- a prohibition on an underwriter suggesting that the underwriter can serve, formally or informally, as the issuer's financial advisor and well as underwriter; and
- disclosure of additional conflicts of interest "to ensure full protection of the issuer from unsettling business practices and relationships," including disclosures about contingent fees and the underwriter's duty to investors.

GFOA also recommended that the MSRB:

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[5] GFOA recommended that, in the case of conflicts disclosures, the disclosures should be made when the underwriter is hired, and, in the case of disclosures concerning a financing, the disclosures should be made on an ongoing basis as the transaction is structured.

- develop and promote educational information for issuers about underwriting pricing and fees and the information that underwriters must disclose and appropriate questions issuers should ask their underwriters;

- consider the application of suitability standards to the transaction an underwriter is proposing to an issuer; and

- look at why, in the absence of significant changes in the market, a bond may trade up in price very soon after the initial pricing (e.g., within 2-5 days) and provide an operational definition of "flipping" and an explanation of why it is not an appropriate practice.

MSRB Response. The MSRB appreciates the comments from GFOA and has incorporated many of GFOA's recommendations in the amended Notice. In particular, the amended Notice would require underwriters to provide issuers with more robust disclosures, including disclosures that, unlike municipal advisors, underwriters do not have a fiduciary duty to issuers under the federal securities laws. It would also require more conflicts of interest disclosures by underwriters. It would also prohibit an underwriter from recommending that the issuer not retain a municipal advisor. The Notice already requires that underwriters disclose the risks associated with complex municipal securities financings, although it does not require that they disclose different types of financings that might be applicable to an issuer's particular situation, as the MSRB considers that to be the duty of a municipal advisor, rather than an underwriter. Additional disclosures (e.g., pending litigation and whether certain personnel had left the firm) that do not rise to the level of conflicts could, of course, be required by issuers as they deem appropriate.

Regarding the other recommendations made by GFOA not related to the Notice, the MSRB is in the process of developing materials designed to educate issuers as to the duties owed them by their underwriters under MSRB rules, as suggested by GFOA. The MSRB would like to engage in a dialogue with GFOA on its other suggestions.

- **Comment: The required underwriter disclosures and duties would mislead issuers and discourage them from retaining municipal advisors.**

NAIPFA said that underwriters should not be able to provide advice to issuers.[6] It said that its preference would be that the MSRB amend Rule G-23 to prohibit underwriters from providing advice to issuers, which it said was inconsistent with the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). NAIPFA said that, if Rule G-23 were so amended, the disclosures required of underwriters under Rule G-17 would be unnecessary.

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[6] WM Financial agreed. It distinguished between "advice" and "information," which it agreed that underwriters should be able to provide.

Alternatively, it said that an underwriter should be required to disclose[7] that it:

- is not acting as an advisor but as an underwriter;
- is not a fiduciary to the issuer but rather a counterparty dealing at arm's length;
- has conflicts with the issuer because it represent the interests of investors or other counterparties; and
- seeks to maximize its profitability, and has no continuing obligation to the issuer following the closing of the transaction.

NAIPFA said that such disclosures would eliminate any confusion on the part of the issuer and would clearly establish that the issuer should not rely on the advice provided by the underwriter.

NAIPFA said that "the dictates of [Rule G-17] prohibiting fraud and manipulation are sufficient" and that the disclosures and duties required by the Notice, including what NAIPFA characterized as a "fiduciary-lite" standard, would confuse municipal issuers (particularly, infrequent, unsophisticated issuers) into thinking that underwriters were acting in their best interests and that they did not need to retain municipal advisors.[8]

NAIPFA also said that the disclosure process for underwriters should be no less than that the MSRB has proposed for municipal advisors. It specifically objected to the following elements of the Notice:

- the price paid by an underwriter to an issuer for its securities must be fair and reasonable;[9]

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[7] WM Financial said that an underwriter should be required to disclose that it is not acting as the issuer's financial advisor and that the issuer should consult with its financial advisor regarding the risks of the transaction and whether the pricing was reasonable.

[8] WM Financial agreed. NAIPFA said that an underwriter should be required to state that it is not a municipal advisor and that the issuer should consult a municipal advisor if it wishes to obtain unbiased advice.

[9] NAIPFA would prefer that it be "not unreasonable," on the theory that putting in place a fair and reasonable pricing requirement is inconsistent with an arm's length commercial transaction, places an unnecessary burden on the underwriting community, is unnecessary to "promote just and equitable principles of trade," and would lead issuers to conclude that their underwriters were not acting at arm's-length.

- underwriters are not required to obtain the informed consent to their conflicts by issuer officials they reasonably believe have the authority to bind the issuers by contract;[10]

- underwriters are allowed to make disclosures to issuer officials based on their reasonable belief that such officials have the authority to bind the issuers by contract, rather than based on their actual knowledge;

- disclosures need not be made to governing bodies (such as city councils), but instead may be made to finance officials of issuers;

- disclosures are not required to be made when underwriters are retained by issuers;

- some of the required underwriter disclosures overlap those that should be provided by municipal advisors;[11]

- underwriters are not required to disclose the basis of their compensation or that contingent fees or fees that depend upon the size of a transaction represent a conflict of interest or that the kind of security issued may affect the underwriter's compensation;

- the Notice does not provide specific guidance on when an issuer has the knowledge and understanding required to nullify the need for disclosures concerning routine financings;[12]

- underwriters are not required to disclose to issuers that their obligations in connection with the preparation of official statements are not the same as those of municipal advisors;[13] and

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[10] NAIPFA said that underwriters could not form such a reasonable belief until a bond purchase agreement was signed.

[11] NAIPFA said that such underwriter disclosures should be eliminated when the issuer is represented by a municipal advisor. WM Financial agreed.

[12] NAIPFA suggested that relevant factors would be whether the issuer has completed one or more public offerings within the last two years and the amount of the issuer's outstanding securities (e.g., more than $100 million of securities outstanding within the last 5 years). NAIPFA also raised the possibility of requiring an underwriter to ascertain whether a particular security is suitable for an issuer.

[13] NAIPFA said that underwriter should be required to disclose that it "can only be held liable" for its work on an official statement if "it can be shown that [it] did not act with a reasonable belief that the information presented as truthful and complete." The Notice actually used a "reasonable basis" standard, as described below.

- underwriters are not prohibited from seeking reimbursements from bond proceeds for expenditures made on behalf of the issuer by the underwriter.[14]

NAIPFA said that the MSRB should require the following for small and/or infrequent issuers:

- the presentation of all underwriting disclosures to the municipal entity's governing body by the underwriter when the underwriter is retained at the onset of the project;

- the inclusion in the initial underwriting disclosures of:

  - the basis for compensation;

  - a statement to the effect that the basis for compensation is a conflict of interest that could cause the underwriter to recommend that the size of the issuance be larger than is necessary;

  - a statement that an underwriter is not a municipal advisor and that the issuer should consult a municipal advisor if it wishes to obtain unbiased advice; and

  - a statement, when applicable, that an official statement prepared from the underwriter's perspective is produced under a different standard than the fiduciary standard of a municipal advisor;

- a standard for ascertaining the issuer's capacity and knowledge with regard to certain kinds of issuances of securities and, if necessary, ascertaining whether a particular security is suitable for that particular issuer;

- the concept that pricing should not be "unreasonable," rather than "fair and reasonable"; and

- a prohibition on underwriters being reimbursed for expenses from bond proceeds absent their obtaining informed, written consent from the issuer.

MSRB Response. The MSRB does not agree that underwriters are precluded from providing advice to municipal entities. It is the view of the MSRB that the exception from the definition of "municipal advisor" in Section 15B(e)(4) of the Securities Exchange Act of 1934 (the "Exchange Act") for "dealers serving as underwriters" would not be necessary if

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[14] NAIPFA said an underwriter should be required to disclose to an issuer that the issuer need not issue additional bonds to reimburse the underwriter.

underwriters were not permitted to provide advice on the structure, timing, terms, and similar matters with respect to the issuance of municipal securities.

The MSRB also does not consider the reduction of the disclosures and duties required of underwriters under the Notice to be the appropriate response to possible issuer confusion about the role of the underwriter compared to that of the municipal advisor. Underwriters are in the best position to understand the material terms and risks associated with financings they recommend, and the burden should not be solely on the municipal advisor to ascertain them. Furthermore, the duties imposed on underwriters by the Notice (e.g., fair and reasonable pricing) are no different in many cases than the duties already imposed on them by MSRB rules with respect to their customers. The approach adopted by the MSRB in the amended Notice would be to require more robust disclosures by underwriters to issuers. Many of those disclosures are the same as those recommended by NAIPFA, specifically those concerning the underwriter's role compared to that of a municipal advisor, contingent fee compensation as a conflict of interest, and the underwriter's other actual or potential material conflicts of interest. An underwriter would generally be required to obtain written acknowledgement of the receipt of such disclosures by an issuer official that has the authority to bind the issuer by contract with the underwriter.

The MSRB does not consider it necessary for underwriters to obtain the consent of issuer governing bodies when issuer finance officials have been delegated the ability to contract with the underwriter, just as the MSRB does not consider it necessary for municipal advisors to obtain the consent of issuer governing bodies in such circumstances. In its comment letter on the MSRB's fiduciary duty proposal,[15] NAIPFA requested that municipal advisors be able to make disclosures to the representative of the municipal entity designated by the municipal entity as the primary contact for the engagement, rather than a governing body. Furthermore, the MSRB does not believe it is necessary for a contract to have actually been executed in order for an underwriter to have a reasonable belief that an issuer official has the requisite power to bind the issuer by contract. The Notice never provided that disclosures could be made only at the time of the signing of a bond purchase agreement. The amended Notice makes it clear that most disclosures must be made at the time an underwriter is first engaged to provide underwriting services. Disclosures triggered by recommendations would still be required to be made in sufficient time before the execution of a contract with the underwriter to allow the official to evaluate the recommendation. The amended Notice requires a "reasonable belief" as to the required disclosure recipient similar to the one NAIPFA itself requested in its comment letters on MSRB proposals concerning required disclosures by municipal advisors.[16]

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[15] See Letter from Colette J. Irwin-Knott, President, dated April 11, 2011, commenting on MSRB Notice Nos. 2011-14 and 2011-13.

[16] Id. NAIPFA requested that a municipal advisor be permitted to rely on the apparent authority of an issuer representative when making the disclosure, provided the advisor had no reason to believe the individual with whom it was dealing lacked the requisite authority.

The MSRB believes that the factors suggested by NAIPFA as to when disclosures concerning routine financings should be required (whether the issuer has completed one or more public offerings within the last two years and the amount of the issuer's outstanding securities (e.g., more than $100 million of securities outstanding within the last 5 years)), while useful, do not adequately address the experience and knowledge of the particular issuer personnel involved in the financing, which is the more relevant standard for such disclosures, as suggested by BDA in its comment letter. The MSRB will take NAIPFA's comment concerning suitability under advisement.

The MSRB considers it unreasonable for NAIPFA to recommend that underwriters disclose to issuers that they are under no obligation to reimburse the underwriter from bond proceeds for expenditures made on behalf of the issuer, such as rating agency trips. The MSRB's Rule G-20 already precludes underwriters from seeking reimbursement for lavish expenditures, especially from bond proceeds, as described in the Notice. It is also a matter of state law as to whether such reimbursements are permissible. MSRB also sees no reason to distinguish between expenses incurred by underwriters on behalf of issuers and those incurred by municipal advisors, which are not restricted in this manner.

The MSRB does not consider it necessary to require underwriters to disclose to issuers that they seek to maximize their profitability and have no continuing obligation to the issuer following the closing of the transaction. The same is true of municipal advisors under MSRB proposals, and municipal advisors are not required to make such disclosures.

Concerning any materials prepared by an underwriter for use in an official statement, the Notice would provide that an underwriter must have "a reasonable basis for the representations it makes, and other material information it provides, to an issuer and to ensure that such representations and information are accurate and not misleading." This "reasonable basis" standard" is based on a statement of the SEC that, "By participating in an offering, an underwriter makes an implied recommendation about the securities. . . . [T]his recommendation itself implies that the underwriter has a reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offerings."[17]

- **Comment: Disclosures are not sufficient to protect issuers.**

WM Financial said that disclosures made by individuals who do not possess a fiduciary duty are not an effective means of protecting municipal issuers. WM Financial cited the case of SEC v. Stifel Nicolaus & Co., Inc., et. al., case no. 2:11-cv-00755, for this proposition.

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[17] See SEC Rel. No. 34-26100 (Sept. 22, 1988) (proposing Exchange Act Rule 15c2-12) at text following note 70.

MSRB Response. The Stifel case concerns a dealer's obligation to a municipal entity as a customer, not as an issuer of municipal securities, and is therefore not on point. Under the amended Notice, the underwriter would be required to disclose to the issuer that it might wish to consider retaining a municipal advisor. The issuer would then be in a position to determine whether it needed a municipal advisor to protect its interests.

- **Comment: The required underwriter disclosures and duties are burdensome and should not be required when an issuer has a municipal advisor.**

SIFMA said that the Notice would impose burdensome disclosure requirements and duties on underwriters that were particularly inappropriate when an issuer had retained a municipal advisor. Specifically, it made the following comments:

- The Notice transforms the duty of fair dealing into a fiduciary-type obligation,[18] imposing affirmative obligations that are burdensome, expensive and unnecessary and might subject underwriters to significant regulatory claims and be inappropriately referenced in private civil actions under state law.

- Underwriters should not be required to provide comprehensive written risk disclosures to municipal issuers that have retained a financial advisor in relation to a transaction. At a minimum, when the municipal entity has engaged a financial advisor or has internal analytical resources with the requisite expertise (such as internal financial professionals with securities issuance experience), it should be the role of those professionals, not the underwriter, to provide the municipal entity with an analysis of the material risks and characteristics of the transaction.[19] It should be the responsibility of the financial advisor to request additional disclosures and information from the underwriter as he or she deems necessary.

- If the municipal entity has no financial advisor and does not have an internal financial department serving that role, any written disclosure requirement on an underwriter should not be triggered unless the municipal issuer informs the underwriter that the issuer lacks knowledge or experience with such structures and specifically requests such written disclosure in writing.

- The written risk disclosure requirements in the Notice are too broad and vague. References in the Notice to "atypical or complex" elements are vague and

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[18] BDA and NAIPFA agreed that the Notice would impose fiduciary-like duties on underwriters. BDA said that any disclosure requirements should be narrowly drawn to avoid "conceptual and practical inconsistencies that would only confuse the parties as to their roles and responsibilities."

[19] BDA and WM Financial agreed.

insufficient to give underwriters notice or certainty as to when the special disclosures for "complex" transactions will be required. Municipal financings that have integrally related derivative components, such as an interest rate swap, have become commonplace and are well understood by issuers. Requiring detailed written disclosures about such financings will cause underwriters to incur costs that will not be justified by any significant additional protection for municipal issuers. If risk disclosure is mandated, the Notice should clarify that the risks required to be disclosed are those material risks that are known to the underwriter and reasonably foreseeable at the time of the disclosure. If a requirement to disclose all material risks and characteristics of a complex transaction were to be implied by the Notice, at most it should relate to disclosures about material financial risks and characteristics of the transaction.

- The underwriter should have not have a duty to evaluate the level of knowledge and sophistication of the issuer.[20] If such an evaluation must be made, there should be more specific guidance regarding which issuer personnel must have the requisite level of knowledge and sophistication so that disclosures to them concerning routine financings are unnecessary. If the issuer has no financial advisor or internal personnel serving in a similar role, SIFMA believes that the issuer's finance staff is probably the most appropriate group as to which the underwriter could make a determination of knowledge and experience with the relevant transaction structure or similar structures.

- The credit default swap ("CDS") disclosure required by the Notice could unduly deter use of CDS for risk management, and potentially compromise counterparty relationships. Generalized disclosures that put the issuer on notice of the possibility that the underwriter may, from time to time, engage in risk management activities are sufficient. Such disclosure is also unnecessary because such typical trading activities are not prejudicial to issuers.

- The MSRB should clarify the extent of the "details" regarding any third-party arrangements for the marketing of the issuer's securities that the underwriter must disclose to the issuer and, whether the information and level of detail typically disclosed in the official statement would be sufficient.

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[20] BDA's comment on this topic was that, especially for routine transactions, underwriters should only be required to provide disclosure on the material aspects of a municipal securities transaction if the underwriter has reason to believe that issuer personnel do not have the knowledge or experience to understand the transaction, regardless of whether the particular issuer officials are ones that the underwriter reasonably believes have the legal authority to contractually bind the issuer. BDA said that an underwriter might have such a reasonable belief if "the issuer personnel had not before been involved in such transactions."

- Internal payments or other internal credits among the underwriter and its affiliates should not be deemed "third-party payments" that need to be disclosed, as they would not raise the same risks of coloring a party's judgment as payments made by true third parties.

- Evaluating an underwriter's substantive basis for its provision of an issue price certificate is a matter more appropriately left to the tax authorities.

- The Notice should be revised to clarify that an underwriter may limit its responsibility for information provided by disclosing to the issuer any limitations on the scope of its analysis and factual verification it performed. In addition, any duty should extend only to material information provided by the underwriter and not to all information and analysis.

- Overall, the Notice would subject underwriters to significant additional burdens and potential incremental liabilities that are not commensurate with the benefits that would accrue to issuers. SIFMA urged the SEC to consider carefully the costs and benefits of the proposal, which it said were not adequately analyzed in the MSRB's filing.

- The proposed implementation period for the Notice of 90 days is not sufficient. Six months is more appropriate.

MSRB Response. As noted above, underwriters are in the best position to understand the material terms and risks associated with financings they recommend, and the burden should not be solely on the municipal advisor to ascertain them. Furthermore, the duties imposed on underwriters by the Notice (e.g., fair and reasonable pricing) are no different in many cases than the duties already imposed on them by MSRB rules with respect to their customers. Those duties are not the equivalent of a fiduciary duty. An underwriter is not required to act in the best interests of an issuer without regard to its own financial and other interests, which is the key element of a fiduciary duty. The underwriter is also not required to consider all reasonably feasible alternatives to the financing it proposes, which is another requirement under the MSRB's fiduciary duty proposal. The key to the elimination of issuer confusion about the role of the underwriter is the requirement of the amended Notice of more robust disclosures by underwriters to issuers about their role compared to that of a municipal advisor, compensation, and other actual or potential material conflicts of interest.

The MSRB also does not consider it appropriate to require the issuer to inform the underwriter that it lacks knowledge or experience with a financing structure as a condition of receiving disclosures from the underwriter. This would put the burden on the party least able to understand the transaction and its rights to disclosure.

The MSRB does not consider it unreasonable to require that an underwriter evaluate the level of knowledge and sophistication of the issuer, particularly considering that under the amended Notice the underwriter need only have a reasonable basis for its evaluation. In many

cases, finance officials of an issuer may have the requisite degree of experience and knowledge. However, particularly in the case of small, infrequent issuers or in the case of frequent turnover of issuer finance officials, that may not be the case.

The MSRB does not consider it appropriate to provide a more precise definition of "complex municipal securities financing" than that already provided in the Notice. The Notice offers the comparison to a fixed rate financing and examples of financings that are considered to be complex, such as those involving VRDOs and swaps. If there is any doubt on the part of the underwriter as to whether a financing is complex, it should err on the side of concluding that the financing is complex and provide the requisite disclosures. The MSRB does, however, agree with SIFMA's comment that disclosures concerning the risks associated with a complex municipal securities financing should be limited to material financial risks that are known to the underwriter and reasonably foreseeable at the time of the disclosure. The amended Notice reflects this change. The amended Notice would also require that the disclosures of the characteristics of a financing would be limited to the material financial characteristics, and endnote 7 to the Notice would provides examples in the case of swaps.

The disclosure required by the amended Notice concerning credit default swaps would in no way compromise counterparty relationships or defer the use of credit default swaps for legitimate risk management purposes. The amended Notice would require only that a dealer that engages in the issuance or purchase of a credit default swap for which the underlying reference is an issuer for which the dealer is serving as underwriter, or an obligation of that issuer, must disclose the fact that it does so to the issuer, not the terms of particular trades.

As to disclosures concerning third-party marketing arrangements, the amended notice would require only the disclosure of their existence, not their particular terms.

The MSRB does not agree with SIFMA that payments from affiliates do not raise the same risks of coloring a party's judgment as payments made by true third parties and, accordingly, has not amended the Notice in response to that comment. However, the amended Notice would not require the disclosure of the amount of such payments.

Concerning the requirement that an underwriter have a reasonable basis for its representations in tax certificates, the MSRB continues to be of the view that this requirement imposes no additional burden on underwriters because Section 6700 of the Internal Revenue Code effectively already imposes an obligation on underwriters not to make statements (including underwriter certificates) material to tax exemption that they know or have "reason to know" are false or fraudulent.

Concerning SIFMA's comment that the Notice should be revised to clarify that an underwriter may limit its responsibility for information provided by disclosing to the issuer any limitations on the scope of its analysis and factual verification it performed, the MSRB reiterates what it said in the SEC filing of the Notice:

> The MSRB does not agree with this comment and reminds SIFMA of the view of the SEC as summarized in endnote 10 to the Notice: With respect to primary offerings of municipal securities, the SEC has noted, "By participating in an offering, an underwriter makes an implied recommendation about the securities." See SEC Rel. No. 34-26100 (Sept. 22, 1988) (proposing Exchange Act Rule 15c2-12) at text following note 70 (the "1988 Proposing Release"). The SEC stated in the 1988 Proposing Release that "this recommendation itself implies that the underwriter has a reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offerings." It would seem a curious result, therefore, for the underwriter not to be required under Rule G-17 to have a reasonable basis for its own representations set forth in the official statement, as well as a reasonable basis for the material information it provides to the issuer in connection with the preparation of the official statement.

The MSRB believes that 90 days is an adequate time period for underwriters to develop the disclosures required by the Notice, especially as noted by SIFMA "underwriters who follow best practices in their dealings with municipal issuers already engage in an open dialogue with the issuers concerning the risks of the transactions being underwritten."

- **Comment: The MSRB should withdraw the Notice and not resubmit it until the SEC has defined "municipal advisor." The swap provisions are premature, because the CFTC and SEC have not finalized their business conduct rules for swaps and security-based swaps.**

SIFMA said that requesting comment on the Notice is premature given that the SEC has not yet adopted a final definition of municipal advisor and given the recent withdrawal by the MSRB of its municipal advisor rule proposals. Among other concerns, it has not yet been determined what constitutes "advice" in various contexts, which communications and activities incidental to underwriting will be covered by the underwriting exclusion from the definition of municipal advisor, and what specific duties will apply to advice and other communications in various contexts.

SIFMA also said that the Notice would impose requirements that are duplicative of other requirements to which underwriters currently are, or will soon become, subject. For example, subjecting underwriters to disclosure obligations when recommending a derivative instrument risks duplicating -- and potentially conflicting with -- the obligations underwriters will have under business conduct standards to be adopted by the SEC and the CFTC. Both BDA and SIFMA said that the portions of the Notice concerning swaps were premature since the CFTC and the SEC have not completed their rules concerning swaps and swap advisors.[21]

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[21] GFOA said that it was important for the MSRB, CFTC, and SEC to work together to ensure that one set of definitions and rules apply to the municipal securities market so that necessary disclosures are not made due to confusing or conflicting regulations.

MSRB Response. The MSRB is aware of ongoing rulemaking by the SEC and the CFTC and has taken care to ensure that any requirements of the Notice are consistent with such rulemaking.