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Stakeholders

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Affected Rules

[Rule G-8](#); [Rule G-19](#)

SEC Approves MSRB Rule G-47 on Time-of-Trade Disclosure Obligations, MSRB Rules D-15 and G-48 on Sophisticated Municipal Market Professionals, and Revisions to MSRB Rule G-19 on Suitability of Recommendations and Transactions

Overview

The Municipal Securities Rulemaking Board (MSRB) received approval from the Securities and Exchange Commission (SEC or Commission) on March 7, 2014 to adopt new MSRB Rule G-47, on time-of-trade disclosure obligations, new MSRB Rules D-15 and G-48, on sophisticated municipal market professionals (SMMPs), and revisions to MSRB Rules G-19, on suitability of recommendations and transactions and G-8 on books and records.¹ The SEC also approved the deletion of interpretive guidance that is being substantively codified by these rule changes, which will be archived and remain available for review on the MSRB's website.

The MSRB has examined its interpretive guidance related to time-of-trade disclosures, SMMPs, and suitability and is consolidating this guidance and codifying it into the several new rules. Additionally, the revisions to Rule G-19 are intended to harmonize the MSRB's suitability rule with the Financial Industry Regulatory Authority's (FINRA) suitability rule. The revisions to Rule G-8, on books and records, are technical changes to conform the rule to revised Rule G-19.

¹ See Exchange Act Release No. 71665 (Mar. 7, 2014), File No. SR-MSRB-2013-07 (Sept. 17, 2013).

The rule changes will become effective on July 5, 2014. Questions concerning this Notice may be directed to Michael L. Post, Deputy General Counsel, or Darlene Brown, Assistant General Counsel, at 703-797-6600.

Summary of Rule Changes

Rule G-47 on Time-of-Trade Disclosures

The MSRB has interpreted the fair-dealing obligation in MSRB Rule G-17 to require a dealer, in connection with a municipal securities transaction, to make certain disclosures to its customer, at or prior to the time-of-trade.²

The MSRB has issued detailed interpretive guidance discussing this requirement in general, as well as in specific scenarios. New Rule G-47 substantively consolidates this guidance into rule language which the MSRB believes will aid dealers and other market participants in understanding, complying with and enforcing these obligations. While the codification streamlines the interpretive guidance, it is not intended to, and does not, substantively change the current obligations.

General Disclosure Obligation

Rule G-47(a) sets forth the general time-of-trade disclosure obligation as currently set forth in the MSRB's interpretive guidance. The rule states that dealers cannot sell municipal securities to a customer, or purchase municipal securities from a customer, without disclosing to the customer, at or prior to the time-of-trade, all material information known about the transaction and material information about the security that is reasonably accessible to the market. The rule applies regardless of whether the transaction is unsolicited or recommended, occurs in a primary offering or the secondary market, and is a principal or agency transaction. The rule provides that the disclosure can be made orally or in writing.

Rule G-47(b) states that information is considered to be "material information" if there is a substantial likelihood that the information would be considered important or significant by a reasonable investor in making an investment decision. The rule defines "reasonably accessible to the market" as information that is made available publicly through "established industry sources." Finally, the rule defines "established industry sources" as including

² See, e.g., [MSRB Answers Frequently Asked Questions Regarding Dealer Disclosure Obligations Under MSRB Rule G-17 \(Nov. 30, 2011\)](#). See [Request for Comment on Codifying Time of Trade Disclosure Obligation \(Feb. 11, 2013\)](#) for a more full discussion of the time-of-trade disclosure guidance that has been consolidated and codified into Rule G-47.

the MSRB's Electronic Municipal Market Access (EMMA®)³ system, rating agency reports, and other sources of information generally used by dealers that effect transactions in the type of municipal securities at issue.

Supplementary Material

In addition, Rule G-47 includes supplementary material providing more detailed guidance on the disclosure obligation. Supplementary Material .01 provides general information regarding the manner and scope of required disclosures. Specifically, this paragraph provides that dealers have a duty to give customers a complete description of the security which includes a description of the features that would likely be considered significant by a reasonable investor, and facts that are material to assessing potential risks of the investment. This paragraph also provides that the public availability of material information through EMMA, or other established industry sources, does not relieve dealers of their disclosure obligations. In addition, this paragraph provides that dealers may not satisfy the disclosure obligation by directing customers to established industry sources or through disclosure in general advertising materials. Finally, this paragraph recognizes that whether the customer is purchasing or selling municipal securities may be a consideration in determining what information is material for purposes of the disclosure obligation.

Supplementary Material .02 provides that dealers operating electronic trading or brokerage systems have the same time-of-trade disclosure obligations as other dealers.

Supplementary Material .03 describes information that may be material in specific scenarios and require disclosures to a customer. The guidance provides that the list is not exhaustive and still other information may be material to a customer in these and other scenarios.

Supplementary Material .04 provides that dealers must implement processes and procedures reasonably designed to ensure that material information regarding municipal securities is disseminated to their registered representatives who are engaged in sales to and purchases from customers.

Applicability to 529 Plans

The guidance discussing time-of-trade disclosure obligations in connection with 529 college savings plans (529 plans) has not been incorporated into Rule G-47. The MSRB may create a separate rule regarding time of trade disclosure obligations for 529 plans or a rule consolidating dealer obligations

³ EMMA is a registered trademark of the MSRB.

related to 529 plans. Until the MSRB adopts a rule specific to 529 plans, Rule G-47 and all such interpretive guidance continues to apply to 529 plans.

Current Interpretive Guidance on Time-of-Trade Disclosure Obligations

The MSRB has identified three interpretive notices to be deleted from the MSRB's Rulebook in their entirety by this codification into rule language.⁴ The MSRB is archiving them on the MSRB website where they will continue to be available for review.⁵ All statements in the remaining MSRB interpretive guidance that refer to Rule G-17 in connection with the time-of-trade disclosure obligation should be read instead to refer to new Rule G-47.

Rule G-19, on Suitability of Recommendations and Transactions

The revisions to Rule G-19 on suitability of recommendations and transactions more closely harmonize the rule with FINRA's suitability rule,⁶ and incorporate elements of the MSRB's current interpretive guidance on suitability.⁷ The revisions to Rule G-19 are aligned with a recommendation of the SEC in its 2012 Report on the Municipal Securities Market.⁸ Given the extensive interpretive guidance surrounding FINRA Rule 2111 and the impracticality and inefficiency of republishing each iteration of that guidance, substantively similar provisions of Rule G-19 will be interpreted in a manner consistent with FINRA's interpretations of Rule 2111. If the MSRB believes any FINRA interpretation should not be applicable to Rule G-19, it will affirmatively state which specific provisions of FINRA's interpretation do not apply. Additionally, the MSRB is making technical amendments to Rule G-8(a)(xi)(F) to conform it to the revisions to Rule G-19.

⁴ [Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts \(Mar. 18, 2002\)](#); [Notice of Interpretation of Rule G-17 Concerning Minimum Denominations \(Jan. 30, 2002\)](#); and [Notice Concerning Disclosure of Call Information to Customers of Municipal Securities \(Mar. 4, 1986\)](#).

⁵ To the extent that archived interpretive guidance does not conflict with any MSRB rules or interpretations thereof, it remains potentially applicable, depending on the facts and circumstances of a particular case.

⁶ See FINRA Rule 2111.

⁷ See [Request for Comment on Revisions to Suitability Rule \(Mar. 11, 2013\)](#) for a more full discussion of the suitability guidance that has been consolidated and condensed into the revisions to Rule G-19.

⁸ See Report on the Municipal Securities Market, at p. 141 (July 2012), available at <http://www.sec.gov/news/studies/2012/munireport073112.pdf>.

Account Information

Currently, MSRB Rule G-19(a) requires dealers to obtain certain customer information before completing a transaction in municipal securities for that customer account. The required customer information consists of, by cross-reference, the customer information required under MSRB Rule G-8(a)(xi), on books and records. An equivalent provision is not included in the revisions to Rule G-19 since MSRB Rule G-8 already independently requires dealers to make and keep a record of this information for each customer. Additionally, deleting this provision streamlines the rule and more closely aligns it with FINRA's suitability rule, which does not have this specific requirement.⁹

Information Required for Suitability Determinations

Existing Rule G-19(b) contains a list of customer information that dealers are required to obtain prior to recommending a transaction to a non-institutional account. The revisions to Rule G-19 expand this list to include additional items also included in FINRA Rule 2111, such as: age, investment time horizon, liquidity needs, investment experience, risk tolerance and "any other information the customer may disclose to the broker, dealer or municipal securities dealer in connection with such recommendation."

In addition, existing Rule G-19(c)(i) requires dealers to have reasonable grounds based on information available from the issuer of the security or otherwise for believing a recommendation is suitable. The supplementary material to FINRA's suitability rule includes similar suitability obligations.¹⁰ In order to fulfill those obligations, dealers necessarily must consider information available from the issuer of the security. Therefore, the revisions to Rule G-19 simply incorporate the suitability provisions from the FINRA rule into Supplementary Material .05 and delete existing section (c)(i) of Rule G-19.

Churning

The revisions to Rule G-19 retain the substance of the existing Rule G-19(e)'s prohibition on churning, but recast it using the current terminology of "quantitative suitability," which is also used in FINRA's suitability rule.¹¹

⁹ Prior to these amendments, the MSRB suitability rule included provisions on discretionary accounts. These provisions are deleted on the grounds that they are largely duplicative of Rule G-8(a)(xi)(I) and encompassed by the revisions to Rule G-19.

¹⁰ FINRA Rule 2111, Supplementary Material .05.

¹¹ See FINRA Rule 2111, Supplementary Material .05(c) and new Rule G-19, Supplementary Material .05(c).

Investment Strategies

The amendments to Rule G-19 apply the suitability obligation to “investment strategies,” further harmonizing the rule with the supplementary material of the FINRA rule. Rule G-19, Supplementary Material .03 provides that the phrase “investment strategy involving a municipal security or municipal securities” is “to be interpreted broadly and would include, among other things, an explicit recommendation to hold a municipal security or municipal securities.” The revised rule, like the FINRA rule, carves out communications of certain types of educational material as long as such communications do not recommend a particular municipal security or municipal securities. The list of educational materials in Rule G-19, Supplementary Material .03, differs in some respects from the list of educational materials in FINRA’s suitability rule to account for the particular attributes of the municipal securities market.

Institutional Accounts

Provisions of the MSRB’s guidance under Rule G-17 and new MSRB Rules D-15 and G-48 (discussed in detail below) exempt dealers from the duty to perform a customer-specific suitability determination for recommendations to customers that are SMMPs.¹² FINRA’s suitability rule has similar provisions with respect to institutional accounts.¹³

Applicability to 529 Plans

The suitability obligations for 529 plans described in the guidance under Rule G-17 are not incorporated into revised Rule G-19. The MSRB may create a separate rule regarding suitability obligations for 529 plans. Until the MSRB adopts a rule specific to 529 plans, MSRB Rule G-19 the related interpretive guidance will continue to apply to 529 plans.

Technical Revisions to Rule G-8, on Books and Records

Existing MSRB Rule G-8(a)(xi)(F) includes references to MSRB Rule G-19(c)(ii) and G-19(b). These referenced provisions are not codified as such in the revisions to MSRB Rule G-19, but the concepts remain in the revised rule.

¹² See, e.g., [Restated Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals \(July 9, 2012\)](#). See also [Request for Comment on Proposed Sophisticated Municipal Market Professional Rules \(May 1, 2013\)](#).

¹³ See FINRA Rule 2111(b).

Therefore, the MSRB is revising MSRB Rule G-8(a)(xi)(F) simply to include a reference to the entire Rule G-19.

Current Interpretive Guidance on Suitability

The MSRB has issued guidance under Rule G-17 on suitability obligations which provides that dealers must take into account material information in meeting their suitability obligations.¹⁴ This is the same type of information that dealers are required to disclose to customers at the time of trade.¹⁵ Rather than listing information in the supplementary material to Rule G-19 that may be material to an investor, Rule G-19, Supplementary Material .05(a) includes a general requirement for dealers to understand information about the municipal security or strategy and explicitly refers to a dealer's obligations under new MSRB Rule G-47, on time-of-trade disclosure. The remaining suitability obligations described in the Rule G-17 guidance¹⁶ are incorporated into revised Rule G-19.

The MSRB also has issued interpretive guidance under existing Rule G-19 that addresses online communications, investment seminars, customers contacting a dealer in response to an advertisement, and other general suitability concepts.¹⁷ This guidance is deleted by the codification into Rule G-19 and will be archived on the MSRB's website as discussed above. The MSRB also has issued various interpretations under Rules G-15, G-21, and G-32 that refer to suitability obligations. Since these interpretations only nominally refer to suitability obligations while addressing other subjects, and are not inconsistent with the revisions to Rule G-19, these interpretations are left intact.

¹⁴ See, e.g., [MSRB Reminds Firms of their Sales Practice and Due Diligence Obligations when Selling Municipal Securities in the Secondary Market \(Sept. 20, 2010\)](#). See also [Request for Comment on Revisions to Suitability Rule \(Mar. 11, 2013\)](#) for a more full discussion of the Rule G-17 suitability guidance.

¹⁵ See, e.g., [Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities \(July 14, 2009\)](#).

¹⁶ [Reminder of Customer Protection Obligations in Connection with Sales of Municipal Securities \(Mar. 30, 2007\)](#); [Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts \(Mar. 18, 2002\)](#); and [Notice Concerning Disclosure of Call Information to Customers of Municipal Securities \(Mar. 4, 1986\)](#).

¹⁷ [Notice Regarding Application of Rule G-19, on Suitability of Recommendations and Transactions, to Online Communications \(Sept. 25, 2002\)](#); [Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer's Advertisements \(Apr. 25, 1985\)](#); [Interpretive Letter, Recommendations \(Feb. 17, 1998\)](#); and [Interpretive Letter, Recommendations: advertisements \(Feb. 24, 1994\)](#).

Rules D-15 and G-48 on SMMPs

New Rules D-15 and G-48 on SMMPs (the SMMP Rules) streamline and codify the existing guidance under Rule G-17 on the application of several other MSRB rules to transactions with SMMPs. Rule D-15 defines an SMMP and Rule G-48 provides the regulatory obligations of dealers to SMMPs. The SMMP Rules will underscore the differences between dealers' obligations to non-SMMPs and SMMPs, while highlighting the eligibility standards for being an SMMP.

Rule D-15 defines the term "sophisticated municipal market professional" or "SMMP" as a customer of a dealer that is a bank, savings and loan association, insurance company, or registered investment company; or an investment adviser registered with the Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or any other entity with total assets of at least \$50 million. Additionally, the dealer must have a reasonable basis to believe that the customer is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions and investment strategies in municipal securities, and affirmatively indicates that it is exercising independent judgment in evaluating the recommendations of the dealer.

The supplementary material to new Rule D-15 addresses the reasonable-basis analysis and the customer affirmation. Supplementary Material .01 states that as part of the reasonable-basis analysis, the dealer should consider the amount and type of municipal securities owned or under management by the customer. Supplementary Material .02 states that a customer may affirm that it is exercising independent judgment either orally or in writing, and such affirmation may be given on a trade-by-trade basis, on a type-of-municipal-security basis, or on an account-wide basis.

Rule G-48 provides, without substantive change from the interpretive guidance under Rule G-17 that is being codified, that a dealer's obligations to a customer that it reasonably concludes is an SMMP are modified with respect to the time-of-trade disclosure obligation in new Rule G-47, transaction pricing obligations under Rule G-18, the suitability obligation in Rule G-19, and the obligation regarding bona fide quotations in Rule G-13.

Interpretive Guidance on SMMPs

Two interpretive notices on SMMPs are deleted in their entirety by the codification of the new SMMP Rules.¹⁸ And two additional interpretive notices that include some information related to SMMPs, time-of-trade disclosures, and suitability are deleted in their entirety by the codification of new Rule G-47, new Rules D-15 and G-48, and the revisions to Rule G-19.¹⁹ The MSRB will archive these notices on its website as discussed above.

March 12, 2014

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Text of Amendments²⁰

Rule G-47: Time of Trade Disclosure

(a) No broker, dealer, or municipal securities dealer shall sell a municipal security to a customer, or purchase a municipal security from a customer, whether unsolicited or recommended, and whether in a primary offering or secondary market transaction, without disclosing to the customer, orally or in writing, at or prior to the time of trade, all material information known about the transaction, as well as material information about the security that is reasonably accessible to the market.

(b) Definitions.

(i) “Established industry sources” shall include the MSRB’s Electronic Municipal Market Access (“EMMA”®) system, rating agency reports, and other sources of information relating to municipal securities transactions generally used by brokers, dealers, and municipal securities dealers that effect transactions in the type of municipal securities at issue.

(ii) “Material information”: Information is considered to be material if there is a substantial likelihood that the information would be considered important or significant by a reasonable investor in making an investment decision.

(iii) “Reasonably accessible to the market” shall mean that the information is made available publicly through established industry sources.

¹⁸ [Restated Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals \(July 9, 2012\)](#) and [Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals \(Apr. 30, 2002\)](#).

¹⁹ [MSRB Answers Frequently Asked Questions Regarding Dealer Disclosure Obligations under MSRB Rule G-17 \(Nov. 30, 2011\)](#) and [Application of MSRB Rules to Transactions in Auction Rate Securities \(Feb. 19, 2008\)](#).

²⁰ Underlining indicates new language; strikethrough indicates deletions.

---Supplementary Material:**.01 Manner and Scope of Disclosure.**

- a. The disclosure obligation includes a duty to give a customer a complete description of the security, including a description of the features that likely would be considered significant by a reasonable investor, and facts that are material to assessing the potential risks of the investment.
- b. The public availability of material information through EMMA, or other established industry sources, does not relieve brokers, dealers, and municipal securities dealers of their obligation to make the required time of trade disclosures to a customer.
- c. A broker, dealer, or municipal securities dealer may not satisfy its disclosure obligation by directing a customer to an established industry source or through disclosure in general advertising materials.
- d. Whether the customer is purchasing or selling the municipal securities may be a consideration in determining what information is material.

.02 Electronic Trading Systems. Brokers, dealers, and municipal securities dealers operating electronic trading or brokerage systems have the same time of trade disclosure obligations as other brokers, dealers, and municipal securities dealers.

.03 Disclosure Obligations in Specific Scenarios. The following examples describe information that may be material in specific scenarios and require time of trade disclosures to a customer. This list is not exhaustive and other information may be material to a customer in these and other scenarios.

- a. Variable rate demand obligations.** A description of the basis on which periodic interest rate resets are determined and the role of the remarketing agent.
- b. Auction rate securities.** Features of the auction process that likely would be considered significant by a reasonable investor and the basis on which periodic interest rate resets are determined. Additional facts that may also be considered material are the duration of the interest rate reset period, information on how the “all hold” and maximum rates are determined, any recent auction failures, and other features of the security found in the official documents of the issue.
- c. Credit risks and ratings.** The credit rating or lack thereof, credit rating changes, credit risk of the municipal security, and any underlying credit rating or lack thereof.
- d. Credit or liquidity enhanced securities.** The identity of any credit enhancer or liquidity provider, terms of the credit facility or liquidity facility, and the credit rating of the credit provider or liquidity provider, including potential rating actions (e.g., downgrade).

e. Insured securities. The fact that a security has been insured or arrangements for insurance have been initiated, the credit rating of the insurance company, and information about potential rating actions with respect to the bond insurance company.

f. Original issue discount bonds. The fact that a security bears an original issue discount since it may affect the tax treatment of a municipal security.

g. Securities sold below the minimum denomination. The fact that a sale of a quantity of municipal securities is below the minimum denomination authorized by the bond documents and the potential adverse effect on liquidity of a customer position below the minimum denomination. *See also Rule G-15(f).*

h. Securities with non-standard features. Any non-standard feature of a municipal security. Additionally, if price/yield calculations are affected by anomalies due to a non-standard feature, this also may be material information about the transaction that must be disclosed to the customer.

i. Bonds that prepay principal. The fact that the security prepays principal and the amount of unpaid principal that will be delivered on the transaction.

j. Callable securities. The fact that a municipal security may be redeemed prior to maturity in-whole, in-part, or in extraordinary circumstances, including sinking fund calls and bonds subject to detachable call features.

k. Put option and tender option bonds. Information concerning the put option or tender option features.

l. Stripped coupon securities. Facts concerning the underlying securities which materially affect the stripped coupon instruments. The unusual nature of these securities and their tax treatment warrants special efforts to provide written disclosures.

m. The investment of bond proceeds. Information on the investment of bond proceeds.

n. Issuer's Intent to Prerefund. An issuer's intent to prerefund an issue.

o. Failure to make continuing disclosure filings. Discovery that an issuer has failed to make filings required under its continuing disclosure agreements.

.04 Processes and Procedures. Brokers, dealers, and municipal securities dealers must implement processes and procedures reasonably designed to ensure that material information regarding municipal securities is disseminated to registered representatives who are engaged in sales to and purchases from a customer.

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Rule G-19: Suitability of Recommendations and Transactions; Discretionary Accounts

~~(a) Account Information.~~ Each broker, dealer and municipal securities dealer shall obtain at or before the completion of a transaction in municipal securities with or for the account of a customer a record of the information required by rule G-8(a)(xi).

~~(b) Non-institutional Accounts.~~ Prior to recommending to a non-institutional account a municipal security transaction, a broker, dealer or municipal securities dealer shall make reasonable efforts to obtain information concerning:

~~(i) the customer's financial status;~~

~~(ii) the customer's tax status;~~

~~(iii) the customer's investment objectives; and~~

~~(iv) such other information used or considered to be reasonable and necessary by such broker, dealer or municipal securities dealer in making recommendations to the customer.~~

The term "institutional account" for the purposes of this section shall have the same meaning as in rule G-8(a)(xi).

~~(c) Suitability of Recommendations.~~ In recommending to a customer any municipal security transaction, a broker, dealer, or municipal securities dealer shall have reasonable grounds:

~~(i) based upon information available from the issuer of the security or otherwise, and~~

~~(ii) based upon the facts disclosed by such customer or otherwise known about such customer for believing that the recommendation is suitable.~~

~~(d) Discretionary Accounts.~~ No broker, dealer or municipal securities dealer shall effect a transaction in municipal securities with or for a discretionary account.

~~(i) except to the extent clearly permitted by the prior written authorization of the customer and accepted in writing by a municipal securities principal or municipal securities sales principal on behalf of the broker, dealer or municipal securities dealer; and~~

~~(ii) unless the broker, dealer or municipal securities dealer first determines that the transaction is suitable for the customer as set forth in section (c) of this rule or unless the transaction is specifically directed by the customer and has not been recommended by the dealer to the customer.~~

~~(e) Churning.~~ No broker, dealer or municipal securities dealer shall recommend transactions in municipal securities to a customer, or effect such transactions or cause such transactions to be effected for a discretionary account, that are excessive in size or frequency in view of information known to such broker,

~~dealer or municipal securities dealer concerning the customer's financial background, tax status, and investment objectives.~~

A broker, dealer or municipal securities dealer must have a reasonable basis to believe that a recommended transaction or investment strategy involving a municipal security or municipal securities is suitable for the customer, based on the information obtained through the reasonable diligence of the broker, dealer or municipal securities dealer to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the broker, dealer or municipal securities dealer in connection with such recommendation.

---Supplementary Material:

.01 General Principles. Implicit in all broker, dealer and municipal securities dealer relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of the MSRB's rules, with particular emphasis on the requirement to deal fairly with all persons. The suitability rule is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct.

.02 Disclaimers. A broker, dealer or municipal securities dealer cannot disclaim any responsibilities under the suitability rule.

.03 Recommended Strategies. The phrase "investment strategy involving a municipal security or municipal securities" used in this rule is to be interpreted broadly and would include, among other things, an explicit recommendation to hold a municipal security or municipal securities. However, the following communications are excluded from the coverage of Rule G-19 as long as they do not include (standing alone or in combination with other communications) a recommendation of a particular municipal security or municipal securities: general financial and investment information, including (i) basic investment concepts, such as risk and return and diversification, (ii) historic differences in the return of asset classes (e.g., equities, bonds, or cash) based on standard market indices, (iii) effects of inflation, (iv) estimates of future retirement income needs, (v) assessment of a customer's investment profile, and (vi) general comparisons between tax-exempt and taxable bonds and the concept of tax-equivalent yield.

.04 Customer's Investment Profile. A broker, dealer or municipal securities dealer shall make a recommendation covered by this rule only if, among other things, the broker, dealer or municipal securities dealer has sufficient information about the customer to have a reasonable basis to believe that the recommendation is suitable for that customer. The factors delineated in Rule G-19 regarding a customer's investment profile generally are relevant to a determination regarding whether a recommendation is suitable for a particular customer, although the level of importance of each factor may vary depending on the facts and circumstances of the particular case. A broker, dealer or municipal securities dealer shall use reasonable diligence to obtain and analyze all of the factors delineated in Rule G-19 unless the broker, dealer or municipal securities dealer has a reasonable basis to believe,

documented with specificity, that one or more of the factors are not relevant components of a customer's investment profile in light of the facts and circumstances of the particular case.

.05 Components of Suitability Obligations. Rule G-19 is composed of three main obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability.

(a) The reasonable-basis obligation requires a broker, dealer or municipal securities dealer to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least *some* investors. In general, what constitutes reasonable diligence will vary depending on, among other things, the complexity of and risks associated with the municipal security or investment strategy and the broker, dealer or municipal securities dealer's familiarity with the municipal security or investment strategy. A broker, dealer or municipal securities dealer's reasonable diligence must provide the broker, dealer or municipal securities dealer with an understanding of the potential risks and rewards associated with the recommended municipal security or strategy and an understanding of information about the municipal security or strategy, including the information described in MSRB Rule G-47 (Time of Trade Disclosure), to the extent such information is material. The lack of such an understanding when recommending a municipal security or strategy violates the suitability rule.

(b) The customer-specific obligation requires that a broker, dealer or municipal securities dealer have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile, as delineated in Rule G-19.

(c) Quantitative suitability requires a broker, dealer or municipal securities dealer who has actual or de facto control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in Rule G-19. No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a broker, dealer or municipal securities dealer has violated the quantitative suitability obligation.

.06 Customer's Financial Ability. Rule G-19 prohibits a broker, dealer or municipal securities dealer from recommending a transaction or investment strategy involving a municipal security or municipal securities or the continuing purchase of a municipal security or municipal securities or use of an investment strategy involving a municipal security or municipal securities unless the broker, dealer or municipal securities dealer has a reasonable basis to believe that the customer has the financial ability to meet such a commitment.

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

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

(i) - (x) No change.

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

(A) - (E) No change.

(F) information about the customer ~~used~~ obtained pursuant to rule G-19(c)(ii) in making recommendations to the customer. For non-institutional accounts, all data obtained pursuant to rule G-19(b) shall be recorded.

(G) - (M) No change.

(xii) - (xxvi) No change.

(b) - (g) No change.

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Rule D-15: Sophisticated Municipal Market Professional

The term “sophisticated municipal market professional” or “SMMP” shall mean a customer of a broker, dealer or municipal securities dealer that is:

(1) a bank, savings and loan association, insurance company, or registered investment company; or

(2) an investment adviser registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or

(3) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least \$50 million; and,

that the broker, dealer or municipal securities dealer has a reasonable basis to believe is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions and investment strategies in municipal securities, and that affirmatively indicates that it is exercising independent judgment in evaluating the recommendations of the broker, dealer or municipal securities dealer.

---Supplementary Material:

.01 Reasonable Basis Analysis. As part of the reasonable basis analysis, the broker, dealer or municipal securities dealer should consider the amount and type of municipal securities owned or under management by the customer.

.02 Customer Affirmation. A customer may affirm that it is exercising independent judgment either orally or in writing, and such affirmation may be given on a trade-by-trade basis, on a type-of-municipal-security basis (e.g., general obligation, revenue, variable rate, etc.), or on an account-wide basis.

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Rule G-48: Transactions with Sophisticated Municipal Market Professionals

A broker, dealer, or municipal securities dealer's obligations to a customer that it reasonably concludes is a Sophisticated Municipal Market Professional, or SMMP, shall be modified as follows:

(a) Time of Trade Disclosure. The broker, dealer, or municipal securities dealer shall not have any obligation under Rule G-47 to ensure disclosure of material information that is reasonably accessible to the market.

(b) Transaction Pricing. The broker, dealer, or municipal securities dealer shall not have any obligation under Rule G-18 to take action to ensure that transactions meeting all of the following conditions are effected at fair and reasonable prices:

(i) the transactions are non-recommended secondary market agency transactions;

(ii) the broker, dealer, or municipal securities dealer's services with respect to the transactions have been explicitly limited to providing anonymity, communication, order matching, and/or clearance functions; and

(iii) the broker, dealer, or municipal securities dealer does not exercise discretion as to how or when the transactions are executed.

(c) Suitability. The broker, dealer, or municipal securities dealer shall not have any obligation under Rule G-19 to perform a customer-specific suitability analysis.

(d) Bona Fide Quotations. The broker, dealer, or municipal securities dealer disseminating an SMMP's "quotation" as defined in Rule G-13, which is labeled as such, shall apply the same standards regarding quotations described in Rule G-13(b) as if such quotations were made by another broker, dealer, or municipal securities dealer.

* * * * *

INTERPRETIVE NOTICE REGARDING RULE G-17, ON DISCLOSURE OF MATERIAL FACTS—March 18, 2002

Rule G-17, the MSRB's fair dealing rule, encompasses two general principles. First, the rule imposes a duty on dealers¹ not to engage in deceptive, dishonest, or unfair practices. This first prong of rule G-17 is essentially an antifraud prohibition.

Second, the rule imposes a duty to deal fairly. Statements in the MSRB's filing for approval of rule G-17 and the SEC's order approving the rule note that rule G-17 was implemented to establish a minimum standard of fair conduct by dealers in municipal securities. In addition to the basic antifraud prohibitions in the rule, the duty to "deal fairly" is intended to "refer to the customs and practices of the municipal securities markets, which may, in many instances differ from the corporate securities markets."² As part of a dealer's obligation to deal fairly, the MSRB has interpreted the rule to create affirmative disclosure obligations for dealers. The MSRB has stated that dealer's affirmative disclosure obligations require that a dealer disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security.³ These obligations apply even when a dealer is acting as an order taker and effecting non recommended secondary market transactions.

Rule G-17 was adopted many years prior to the adoption of SEC Rule 15c2-12. The development of the NRMSIR system,⁴ the MSRB's Municipal Securities Information Library[®] (MSIL[®]) system⁵ and Transaction Reporting System ("TRS"),⁶ rating agencies and indicative data sources in the post Rule 15c2-12 era have created much more readily available information sources. Recently, the market has made progress and market professionals (including institutional investors) can, and do, go to these industry sources to find securities descriptive information, official statements, rating agency ratings and reports, and ongoing disclosure information. These developments suggest a need for further explanation of what "disclosure of all material facts" means in today's market.

Rule G-17 requires that dealers disclose to a customer at the time of trade all material facts about a transaction known by the dealer. In addition, a dealer is required to disclose material facts about a security when such facts are reasonably accessible to the market. Thus, a dealer would be responsible for disclosing to a customer any material fact concerning a municipal security transaction made publicly available through sources such as the NRMSIR system, the MSIL[®] system, TRS, rating agency reports and other sources of information relating to the municipal securities transaction generally used by dealers that effect transactions in the type of municipal securities at issue (collectively, "established industry sources").⁷

The customs and practices of the industry suggest that the sources of information generally used by a dealer that effects transactions in municipal securities may vary with the type of municipal security. For example, a dealer might have to draw on fewer industry sources to disclose all material facts about an insured "triple A" rated general obligation bond than for a non-rated conduit issue. In addition, to the extent that a security is more complex, for example because of complex structure or where credit quality is changing rapidly, a dealer might need to take into account a broader range of information sources prior to executing a transaction.

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." The SEC stated, "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."⁸ Similarly, if a dealer recommends a secondary market municipal security transaction, rule G-19 requires a dealer to "have reasonable grounds for the recommendation in light of information available from the issuer or otherwise."⁹ If this "reasonable basis" suitability cannot be obtained from the established industry sources, then further review may be necessary before making a recommendation. To the extent that such review elicits material information that would not have become known through a review of established industry sources, dealers recommending transactions would be obligated to disclose such information in addition to information available from established industry sources.

¹ The term "dealer" is used in this interpretive notice as shorthand for "broker," "dealer" or "municipal securities dealer," as those terms are defined in the Securities Exchange Act of 1934. The use of the term in this interpretive notice does not imply that the entity is necessarily taking a principal position in a municipal security.

² See Exchange Act Release No. 13987 (Sept. 22, 1977).

³ See e.g., *Rule G-17 Interpretation-Educational Notice on Bonds Subject to "Detachable" Call Features, May 13, 1993, MSRB Rule Book (July 2001)* at 129-130. The SEC described material facts as those "facts which a prudent investor should know in order to evaluate the offering before reaching an investment decision." *Municipal Securities Disclosure, Securities Exchange Act Release No. 26100 (September 22, 1988)* (the "1988 SEC Release") at note 76, quoting *In re Walston & Co. Inc., and Harrington, Securities Exchange Act Release No. 8165 (September 22, 1967)*. Furthermore, the United States Supreme Court has stated that a fact is material if there is a substantial likelihood that its disclosure would have been considered significant by a reasonable investor. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).

⁴ For purposes of this notice, the "NRMSIR system" refers to the disclosure dissemination system adopted by the SEC in SEC Rule 15c2-12. Under Rule 15c2-12, as adopted in 1989, participating underwriters provide a copy of the final official statement to Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs") to reduce their obligation to provide a final official statement to customers. In the 1994 amendments to Rule 15c2-12 the SEC determined to require that annual financial information and audited financial statements submitted in accordance with issuer undertakings must be delivered to each NRMSIR and to the State Information Depository ("SID") in the issuer's state, if such depository has been established. The requirement to have annual financial information and audited financial statements delivered to all NRMSIRs and the appropriate SID was included in Rule 15c2-12 to ensure that all NRMSIRs receive disclosure information directly. Under the 1994 amendments, notices of material events, as well as notices of a failure by an issuer or other obligated person to provide annual financial information, must be delivered to each NRMSIR or the MSRB, and the appropriate SID.

⁵The MSIL[®] system collects and makes available to the marketplace official statements and advance refunding documents submitted under MSRB rule G-36, as well as certain secondary market material event disclosures provided by issuers under SEC Rule 15c2-12. Municipal Securities Information Library[®] and MSIL[®] are registered trademarks of the MSRB.

⁶The MSRB's TRS collects and makes available to the marketplace information regarding inter-dealer and dealer-customer transactions in municipal securities.

⁷Dealers operating electronic trading platforms have inquired whether providing electronic access to material information is consistent with the obligation to disclose information under rule G-17. The MSRB believes that the provision of electronic access to material information to customers who elect to transact in municipal securities on an electronic platform is generally consistent with a dealer's obligation to disclose such information, but that whether such access is effective disclosure ultimately depends upon the particular facts and circumstances present.

⁸1988 SEC Release at text following note 70. The SEC also stated that an underwriter must review the issuer's disclosure documents for possible inaccuracies and omissions. In the case of a negotiated offering, the SEC expects the underwriter to make an inquiry into the key representations included in the disclosure materials. In the case of a competitive offering, the SEC acknowledges that the underwriter may have more limited opportunities to undertake such a review and investigation but nonetheless is obligated to take appropriate actions under the particular facts and circumstances of such offering.

⁹See e.g., Rule G-19 Interpretation—Notice Concerning the Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer's Advertisement, May 7, 1985 MSRB Rule Book (July 2001) at 134; *In re F.J. Kaufman and Company of Virginia*, 50 S.E.C. 164, 168, 1989 SEC LEXIS 2376, *10 (1989) (discussing "reasonable basis" suitability).

* * * * *

~~NOTICE OF INTERPRETATION OF RULE G-17 CONCERNING MINIMUM DENOMINATIONS—January 30, 2002~~

Municipal securities issuers sometimes set a relatively high minimum denomination, typically \$100,000, for certain issues. This may be done so that the issue can qualify for one of several exemptions from Securities Exchange Act Rule 15c2-12, meaning that the issue would not be subject to certain primary market or continuing disclosure requirements. In other situations, issuers may set a high minimum denomination even though the issue is subject to Securities Exchange Act Rule 15c2-12. This may be because of the issuer's (or the underwriter's) belief that the securities are not an appropriate investment for those retail investors who would be likely to purchase securities in relatively small amounts.

Several issuers have expressed concern to the MSRB upon discovering that their issues with high minimum denominations were trading in the secondary market in transaction amounts much lower than the stated minimum denomination.¹ Based on information obtained from the MSRB Transaction Reporting Program, it appears that there are significant numbers of these types of transactions. In the past, brokers, dealers

and municipal securities dealers (collectively "dealers") effecting such transactions likely would have had the problem brought to their attention when attempting to make delivery of a certificate to the customer. This is because the transfer agent would not have been able to honor a request for a certificate with a par value below the minimum denomination. Today, however, increased use of book entry deliveries and safekeeping arrangements for retail customers largely preclude the need for individual certificates for customers and there is no other systemic screening to identify transactions that are in below minimum denomination amounts.

Rule G-17 states: "In the conduct of its municipal securities activities, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice." The MSRB has interpreted this rule to mean, among other things, that dealers are required to disclose, at or before a transaction in municipal securities with a customer, all material facts concerning the transaction, including a complete description of the security. The MSRB has proposed an amendment to rule G-15 that would prohibit transactions in below minimum denomination amounts for municipal securities issued after June 1, 2002, with certain limited exceptions.² The MSRB anticipates that some transactions in below minimum denomination amounts may continue to occur for issues issued prior to June 1, 2002, as well as under the limited exceptions to the proposed amendment to rule G-15.³ In either case, the MSRB believes that any time a dealer is selling to a customer a quantity of municipal securities below the minimum denomination for the issue, the dealer should consider this to be a material fact about the transaction. The MSRB believes that a dealer's failure to disclose such a material fact to the customer, and to explain how this could affect the liquidity of the customer's position, generally would constitute a violation of the dealer's duty under rule G-17 to disclose all material facts about the transaction to the customer.

¹ Occasionally, bond documents may state a minimum transaction amount that applies only to primary market transactions, but with a clear indication by the issuer that transactions may occur at lower amounts in the secondary market. The MSRB is not aware of non-authorized transaction amounts occurring for issues of these types. In general, however, bond documents describing a minimum "denomination" would appear to be intended to apply to both primary and secondary market transactions.

² Proposed rule change SR-MSRB-2001-07, filed with the Securities and Exchange Commission on October 16, 2001.

³ Even for municipal securities issued after June 1, 2002, below minimum denomination transactions may need to be effected in compliance with proposed MSRB rule G-15(f) to liquidate below minimum denomination positions created through the exercise of a will, division of a marital estate, as a result of an investor giving a portion of a position as a gift, etc. In addition, the exercise of a sinking fund or other partial redemption by an issuer can sometimes result in customers holding below minimum denomination amounts.

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**~~NOTICE CONCERNING DISCLOSURE OF CALL INFORMATION TO CUSTOMERS OF MUNICIPAL SECURITIES—
March 4, 1986~~**

~~The Board has been made aware of instances in which dealers are not adequately describing securities to customers at the time of trade and may not disclose that bonds are subject to redemption, in whole or in part, prior to maturity. In addition, the Board understands that even when this disclosure is made, and a customer asks for further information concerning the call features, in some instances a dealer may not have this information available.~~

~~Rule G-17 of the Board's rules of fair practice requires municipal securities brokers and dealers to deal fairly with all persons and prohibits them from engaging in any deceptive, dishonest, or unfair practice. The Board has interpreted this rule to require that a dealer must disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security, and must not omit any material facts which would render other statements misleading. In addition, rule G-19, on suitability, prohibits a municipal securities professional from recommending transactions in municipal securities to a customer unless the professional has reasonable grounds for making the recommendation in light of information about the security available from the issuer or otherwise and believes that a transaction in the security is suitable for the particular customer.~~

~~The fact that a security may be redeemed prior to maturity in whole, in part, or in extraordinary circumstances, is essential to a customer's investment decision about the security and is one of the facts a dealer must disclose at the time of trade. In addition, a dealer, if asked by a customer for more specific information regarding a call feature, should obtain this information and relay it to the customer promptly. Moreover, it would be difficult for a dealer to recommend the purchase of a security to a customer without having information regarding the security's call features.~~

~~With respect to confirmations, rule G-15(a) requires dealers to note on customer confirmations if a security is subject to redemption prior to maturity (callable) and to include a legend stating that "call features may exist which could affect yield; complete information will be provided upon request." Thus, a customer, upon receipt of the confirmation, may ask for further information on call features, and dealers have a duty to obtain and disclose such information promptly. Of course, a confirmation is not received by a customer until after a transaction is effected and the Board wishes to emphasize that confirmation disclosures do not eliminate the duty of a municipal securities professional to explain the security adequately to a customer.~~

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**~~NOTICE REGARDING APPLICATION OF RULE G-19, ON SUITABILITY OF RECOMMENDATIONS AND
TRANSACTIONS, TO ONLINE COMMUNICATIONS—September 25, 2002~~**

~~In the municipal securities markets, dealers¹ typically communicate with investors one on one, in person, or by telephone. These dealer/customer communications are made to provide the investor with information concerning the municipal securities the dealer wants to sell and to allow the dealer to find out about the customer's investment objectives. Over the last few years there has been a dramatic increase in~~

the use of the Internet for communication between dealers and their customers. Dealers are looking to the Internet as a mechanism for offering customers new and improved services and for enhancing the efficiency of delivering traditional services to customers. For example, dealers have developed online search tools that computerize the process by which customers can obtain and compare information on the availability of municipal securities of a specific type that are offered for sale by a particular dealer.² Technological advancements have provided many benefits to investors and the brokerage industry. These technological innovations, however, also have presented new regulatory challenges, including those arising from the application of the suitability rule to online activities. In consideration of this, the Municipal Securities Rulemaking Board (“MSRB”) is issuing this notice to provide dealers with guidance concerning their obligations under MSRB Rule G-19, relating to suitability of recommendations,³ in the electronic environment.⁴

Rule G-19 prohibits a dealer from recommending transactions in municipal securities to a customer unless the dealer makes certain determinations with respect to the suitability of the transactions.⁵ Specifically, the dealer must have reasonable grounds for believing that the recommendation is suitable based upon information available from the issuer of the security or otherwise and the facts disclosed by the customer or otherwise known about such customer.

As the rule states, a dealer’s suitability obligation only applies to securities that the dealer recommends to a customer.⁶ A dealer or associated person who simply effects a trade initiated by a customer without a related recommendation from the dealer or associated person is not required to perform a suitability analysis. However, under MSRB Rules, even when a dealer does not recommend a municipal security transaction to a customer but simply effects or executes the transaction, the dealer is obligated to fulfill certain other important fair practice obligations. For example, under Rule G-17, when effecting a municipal security transaction for a customer, a dealer is required to disclose all material facts about a municipal security that are known by the dealer and those that are reasonably accessible.⁷ In addition, Rule G-18 requires that each dealer, when executing a municipal securities transaction for or on behalf of a customer as agent, make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions. Similarly, under Rule G-30, if a dealer engages in principal transactions with a customer, the dealer is responsible for ensuring that it is charging a fair and reasonable price. The MSRB wishes to emphasize the importance of these fair practice obligations even when a dealer effects a non-recommended transaction online.⁸

Applicability of the Suitability Rule to Electronic Communications—General Principles

There has been much debate about the application of the suitability rule to online activities.⁹ Industry commentators and regulators have debated two questions: first, whether the current suitability rule should even apply to online activities, and second, if so, what types of online communications constitute recommendations for purposes of the rule. The NASD published *NASD Notice to Members 01-23, Online Suitability—Suitability Rule and Online Communication* (the “NASD Online Suitability Notice”) (April 2001) to provide guidance to its members in April 2001.¹⁰ In answer to the first question, the MSRB, like the NASD, believes that the suitability rule applies to all recommendations made by dealers to customers—including those made via electronic means—to purchase, sell, or exchange a security. Electronic communications from dealers to their customers clearly can constitute recommendations. The suitability rule, therefore,

remains fully applicable to online activities in those cases where the dealer recommends securities to its customers.

With regard to the second question, the MSRB does not seek to identify in this notice all of the types of electronic communications that may constitute recommendations. As the MSRB has often emphasized, "[w]hether a particular transaction is in fact recommended depends on an analysis of all the relevant facts and circumstances."¹¹ That is, the test for determining whether any communication (electronic or traditional) constitutes a recommendation remains a "facts and circumstances" inquiry to be conducted on a case-by-case basis.

The MSRB also recognizes that many forms of electronic communications defy easy characterization. The MSRB believes this is especially true in the online municipal securities market, which is in a relatively early stage of development. Nevertheless, the MSRB offers as guidance the following general principles for dealers to use in determining whether a particular communication could be deemed a recommendation.¹² The "facts and circumstances" determination of whether a communication is a recommendation requires an analysis of the content, context, and presentation of the particular communication or set of communications. The determination of whether a recommendation has been made, moreover, is an objective rather than a subjective inquiry. An important factor in this regard is whether—given its content, context, and manner of presentation—a particular communication from a dealer to a customer reasonably would be viewed as a "call to action," or suggestion that the customer engage in a securities transaction. Dealers should bear in mind that an analysis of the content, context, and manner of presentation of a communication requires examination of the underlying substantive information transmitted to the customer and consideration of any other facts and circumstances, such as any accompanying explanatory message from the dealer.¹³ Another principle that dealers should keep in mind is that, in general, the more individually tailored the communication is to a specific customer or a targeted group of customers about a security or group of securities, the greater the likelihood is that the communication may be viewed as a recommendation.

Scope of the Term Recommendation

As noted earlier, the MSRB agrees with and has in this guidance adopted the general principles enunciated in the NASD Online Suitability Notice as well as the NASD guidelines for evaluating suitability obligations discussed below. While the MSRB believes that the additional examples of communications that do not constitute recommendations provided by the NASD in its Online Suitability Notice are useful instruction for dealers who develop equity trading web sites, as the examples are based upon communications that exist with great regularity in the Nasdaq market, the MSRB believes that the examples have limited application to the types of information and electronic trading systems that are present in the municipal securities market.

For example, the NASD's third example of a communication that is not a recommendation describes a system that permits customer directed searches of a "wide universe" of securities and references all exchange listed or Nasdaq securities, or externally recognized indexes.¹⁴ The NASD example therefore applies to dealer web sites that effectively allow customers to request lists of securities that meet broad objective criteria from a list of all the securities available on an exchange or Nasdaq. These are examples

of groups of securities in which the dealer does not exercise any discretion as to which securities are contained within the group of securities shown to customers. This example makes sense in the equity market where there are centralized exchanges and where electronic trading platforms routinely utilize databases that provide customer access to all of the approximately 7,300 listed securities on Nasdaq, the NYSE and Amex. However, no dealer in the municipal securities market has the ability to offer all of the approximately 1.3 million outstanding municipal securities for sale or purchase. The municipal securities market is a fragmented dealer market. Municipal securities do not trade through a centralized exchange and only a small number of securities (approximately 10,000) trade at all on any given day. Therefore, there is no comparable central exchange that could serve as a reference point for a database that is used in connection with municipal securities research engines. The databases used by dealer systems typically are limited to the municipal securities that a dealer, or a consortium of dealers, holds in inventory. In these types of systems the customer's ability to search for desirable securities that meet the broad, objective criteria chosen by the customer (e.g., all insured investment grade general obligation bonds offered by a particular state) is limited. The concept of a wide universe of securities, which is central to all of the NASD's examples, is thus difficult to define and has extremely limited, or no, application in the municipal securities market.

Given the distinct features of the municipal securities market and the existing online trading systems, the MSRB believes it would be impractical to attempt to define the features of an electronic trading system that would have to be present for the system transactions to not be considered the result of a dealer recommendation. The online trading systems for municipal securities that are in place today limit customer choices to the inventory that the dealer or dealer consortium hold, and therefore, the dealer will always have a significant degree of discretion over the securities offered to the customer. A system that allows this degree of dealer discretion is a dramatic departure from the types of no recommendation examples provided by the NASD guidance, and thus, these communications must be carefully analyzed to determine whether or not a recommendation has been made.

The MSRB, however, does believe that the examples of communications that are recommendations provided in the NASD Online Suitability Notice are communications that take place in the municipal securities market. Therefore, the MSRB has adopted these examples and generally would view the following communications as falling within the definition of recommendation:

- A dealer sends a customer specific electronic communication (e.g., an e-mail or pop-up screen) to a targeted customer or targeted group of customers encouraging the particular customer(s) to purchase a municipal security.¹⁵
- A dealer sends its customers an e-mail stating that customers should be invested in municipal securities from a particular state or municipal securities backed by a particular sector (such as higher education) and urges customers to purchase one or more stocks from a list with "buy" recommendations.
- A dealer provides a portfolio analysis tool that allows a customer to indicate an investment goal and input personalized information such as age, financial condition, and risk tolerance. The dealer in

this instance then sends (or displays to) the customer a list of specific municipal securities the customer could buy or sell to meet the investment goal the customer has indicated.¹⁶

• A dealer uses data mining technology (the electronic collection of information on Web Site users) to analyze a customer's financial or online activity—whether or not known by the customer—and then, based on those observations, sends (or "pushes") specific investment suggestions that the customer purchase or sell a municipal security.

Dealers should keep in mind that these examples are meant only to provide guidance and are not an exhaustive list of communications that the MSRB does consider to be recommendations. As stated earlier, many other types of electronic communications are not easily characterized. In addition, changes to the factual predicates upon which these examples are based (or the existence of additional factors) could alter the determination of whether similar communications may or may not be viewed as recommendations. Dealers, therefore, should analyze all relevant facts and circumstances, bearing in mind the general principles noted earlier and discussed below, to determine whether a communication is a recommendation, and they should take the necessary steps to fulfill their suitability obligations. Furthermore, these examples are based on technological services that are currently used in the marketplace. They are not intended to direct or limit the future development of delivery methods or products and services provided online.

Guidelines for Evaluating Suitability Obligations

Dealers should consider, at a minimum, the following guidelines when evaluating their suitability obligations with respect to municipal securities transactions.¹⁷ None of these guidelines is determinative of whether a recommendation exists. However, each should be considered in evaluating all of the facts and circumstances surrounding the communication and transaction.

• A dealer cannot avoid or discharge its suitability obligation through a disclaimer where the particular communication reasonably would be viewed as a recommendation given its content, context, and presentation.¹⁸ The MSRB, however, encourages dealers to include on their web sites (and in other means of communication with their customers) clear explanations of the use and limitations of tools offered on those sites.¹⁹

• Dealers should analyze any communication about a security that reasonably could be viewed as a "call to action" and that they direct, or appear to direct, to a particular individual or targeted group of individuals—as opposed to statements that are generally made available to all customers or the public at large—to determine whether a recommendation is being made.²⁰

• Dealers should scrutinize any communication to a customer that suggests the purchase, sale, or exchange of a municipal security—as opposed to simply providing objective data about a security—to determine whether a recommendation is being made.²¹

• A dealer's transmission of unrequested information will not necessarily constitute a recommendation. However, when a dealer decides to send a particular customer unrequested

information about a security that is not of a generalized or administrative nature (e.g., notification of an official communication), the dealer should carefully review the circumstances under which the information is being provided, the manner in which the information is delivered to the customer, the content of the communication, and the original source of the information. The dealer should perform this review regardless of whether the decision to send the information is made by a representative employed by the dealer or by a computer software program used by the dealer.

Dealers should be aware that the degree to which the communication reasonably would influence an investor to trade a particular municipal security or group of municipal securities—either through the context or manner of presentation or the language used in the communication—may be considered in determining whether a recommendation is being made to the customer.

The MSRB emphasizes that the factors listed above are guidelines that may assist dealers in complying with the suitability rule. Again, the presence or absence of any of these factors does not by itself control whether a recommendation has been made or whether the dealer has complied with the suitability rule. Such determinations can be made only on a case by case basis taking into account all of the relevant facts and circumstances.

Conclusion

The foregoing discussion highlights some suggested principles and guidelines to assist in determining when electronic communications constitute recommendations, thereby triggering application of the MSRB's suitability rule. The MSRB acknowledges the numerous benefits that may be realized by dealers and their customers as a result of the Internet and online brokerage services. The MSRB emphasizes that it neither takes a position on, nor seeks to influence, any dealer's or customer's choice of a particular business model in this electronic environment. At the same time, however, the MSRB urges dealers both to consider carefully whether suitability requirements are adequately being addressed when implementing new services and to remember that customers' best interests must continue to be of paramount importance in any setting, traditional or online.

As new technologies and/or services evolve, the MSRB will continue to work with regulators, members of the industry and the public on these and other important issues that arise in the online trading environment.

¹ The term "dealer" is used in this notice as shorthand for "broker," "dealer" or "municipal securities dealer," as those terms are defined in the Securities Exchange Act of 1934. The use of the term in this notice does not imply that the entity is necessarily taking a principal position in a municipal security.

² The Bond Market Association's ("TBMA") 2001 Review of Electronic Transaction Systems found that at the end of 2001, there were at least 23 systems based in the United States that allow dealers or institutional investors to buy or sell municipal securities electronically compared to just 3 such systems in 1997. While dealers are also developing electronic trading platforms that allow retail customers to buy or

sell municipal securities online, the development of online retail trading systems for municipal securities lags far behind that for equities.

³ Rule G-19 provides in pertinent part:

(c) Suitability of Recommendations. In recommending to a customer any municipal security transaction, a [dealer] shall have reasonable grounds:

(i) based upon information available from the issuer of the security or otherwise, and

(ii) based upon the facts disclosed by such customer or otherwise known about such customer for believing that the recommendation is suitable.

⁴ Although the focus of this notice is on the application of the suitability rule to electronic communications, much of the discussion is also relevant to more traditional communications, such as discussions made in person, over the telephone, or through postal mail.

⁵ This notice focuses on customer-specific suitability under Rule G-19. Under Rule G-19, a dealer must also have a reasonable basis to believe that the recommendation could be suitable for at least some customers. See e.g., Rule G-19 Interpretation—Notice Concerning the Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer’s Advertisement, May 7, 1985, *MSRB Rule Book* (July 1, 2002) at 143; *In re F.J. Kaufman and Company of Virginia*, 50 S.E.C. 164, 168, 1989 SEC LEXIS 2376, *10 (1989) (the “reasonable basis” obligation relates only to the particular recommendation, rather than to any particular customer). The SEC, in its discussion of municipal underwriters’ responsibilities in a 1988 Release, noted that “a broker-dealer recommending securities to investors implies by its recommendation that it has an adequate basis for the recommendation.” *Municipal Securities Disclosure*, Securities Exchange Act Release No. 26100 (September 22, 1988) (the “1988 SEC Release”) at text accompanying note 72.

⁶ Similarly, the suitability rule does not apply where a dealer merely gathers information on a particular customer, but does not make any recommendations. This is true even if the information is the type of information generally gathered to satisfy a suitability obligation. Dealers should nonetheless remember that regardless of any determination of whether the dealer is making a recommendation and subject to the suitability requirement, the dealer is required to make reasonable efforts to obtain certain customer specific information pursuant to rule G-8 (a)(xi) so that dealers can protect themselves and the integrity of the securities markets from customers who do not have the financial means to pay for transactions.

⁷ See Rule G-17 Interpretation—Notice Regarding Rule G-17, on Disclosure of Material Facts, March 18, 2002, *MSRB Rule Book* (July 1, 2002) at 135.

⁸ On April 30, 2002, the Securities and Exchange Commission (“SEC”) approved a proposed rule change relating to the manner in which dealers fulfill their fair practice obligations to certain institutional customers. Release No. 34-45849 (April 30, 2002), 67 FR 30743. See Rule G-17 Interpretation—Notice Regarding the Application of MSRB Rules to Transactions With Sophisticated Municipal Market

Professionals (“SMMPs”) (the “SMMP Notice”), *MSRB Rule Book* (July 1, 2002) at 136. The SMMP Notice recognizes the different capabilities of SMMPs and retail or non-sophisticated institutional customers and provides that dealers may consider the nature of the institutional customer when determining what specific actions are necessary to meet the dealer’s fair practice obligations to such customers. The SMMP Notice provides that, while it is difficult to define in advance the scope of a dealer’s fair practice obligations with respect to a particular transaction, by making a reasonable determination that an institutional customer is an SMMP, then certain of the dealer’s fair practice obligations remain applicable but are deemed fulfilled.

⁹ See generally Report of Commissioner Laura S. Unger to the SEC, *On-Line Brokerage: Keeping Apace of Cyberspace*, at n. 64 (Nov. 1999) (“Unger Report”) (discussing various views espoused by online brokerage firms, regulators and academics on the topic of online suitability); *Developments in the Law—The Law of Cyberspace*, 112 Harv. L. Rev. 1574, 1582–83 (1999) (The article highlights the broader debate by academics and judges over whether “to apply conventional models of regulation to the Internet.”)

¹⁰ The guidance contained in this notice is intended to be consistent with the general statements and guidelines contained in the NASD Online Suitability Notice.

¹¹ See e.g., Rule G-19 Interpretive Letter dated February 17, 1998, *MSRB Rule Book* (July 1, 2002) at 144.

¹² These general principles were first enunciated in the NASD Online Suitability Notice.

¹³ For example, if a dealer transmitted a rating agency research report to a customer at the customer’s request, that communication may not be subject to the suitability rule; whereas, if the same dealer transmitted the very same research report with an accompanying message, either oral or written, that the customer should act on the report, the suitability analysis would be different.

¹⁴ NASD Online Suitability Notice at 3.

¹⁵ Note that there are instances where sending a customer an electronic communication that highlights a particular municipal security (or securities) will not be viewed as a recommendation. For instance, while each case requires an analysis of the particular facts and circumstances, a dealer generally would not be viewed as making a recommendation when, pursuant to a customer’s request, it sends the customer (1) electronic “alerts” (such as account activity alerts, market alerts, or rating agency changes) or (2) research announcements (e.g., sector reports) that are not tailored to the individual customer, as long as neither—given their content, context, and manner of presentation—would lead a customer reasonably to believe that the dealer is suggesting that the customer take action in response to the communication.

¹⁶ Note, however, that a portfolio analysis tool that merely generates a suggested mix of general classes of financial assets (e.g., 60 percent equities, 20 percent bonds, and 20 percent cash equivalents), without an accompanying list of securities that the customer could purchase to achieve that allocation, would not trigger a suitability obligation. On the other hand, a series of actions which may not constitute recommendations when considered individually, may amount to a recommendation when considered in the aggregate. For example, a portfolio allocator’s suggestion that a customer could alter his or her current

mix of investments followed by provision of a list of municipal securities that could be purchased or sold to accomplish the alteration could be a recommendation. Again, however, the determination of whether a portfolio analysis tool's communication constitutes a recommendation will depend on the content, context, and presentation of the communication or series of communications.

¹⁷ ~~These guidelines were originally set forth in the NASD Online Suitability Notice.~~

¹⁸ ~~Although a dealer cannot disclaim away its suitability obligation, informing customers that generalized information provided is not based on the customer's particular financial situation or needs may help clarify that the information provided is not meant to be a recommendation to the customer. Whether the communication is in fact a recommendation would still depend on the content, context, and presentation of the communication. Accordingly, a dealer that sends a customer or group of customers information about a security might include a statement that the dealer is not providing the information based on the customers' particular financial situation or needs. Dealers may properly disclose to customers that the opinions or recommendations expressed in research do not take into account individual investors' circumstances and are not intended to represent recommendations by the dealer of particular municipal securities to particular customers. Dealers, however, should refer to previous guidelines issued by the SEC that may be relevant to these and/or related topics. For instance, the SEC has issued guidelines regarding whether and under what circumstances third party information is attributable to an issuer, and the SEC noted that the guidance also may be relevant regarding the responsibilities of dealers. See SEC Guidance on the Use of Electronic Media, Release Nos. 34-7856, 34-42728, IC-24426, 65 Fed. Reg. 25843 at 25848-25849 (April 28, 2000).~~

¹⁹ ~~The MSRB believes that a dealer should, at a minimum, clearly explain the limitations of its search engine and the decentralized nature of the municipal securities market. The dealer should also clearly explain that securities that meet the customer's search criteria might be available from other sources.~~

²⁰ ~~The MSRB notes that there are circumstances where the act of sending a communication to a specific group of customers will not necessarily implicate the suitability rule. For instance, a dealer's business decision to provide only certain types of investment information (e.g., research reports) to a category of "premium" customers would not, without more, trigger application of the suitability rule. Conversely, dealers may incur suitability obligations when they send a communication to a large group of customers urging those customers to invest in a municipal security.~~

²¹ ~~As with the other general guidelines discussed in this notice, the presence of this factor alone does not automatically mean that a recommendation has been made.~~

* * * * *

~~APPLICATION OF SUITABILITY REQUIREMENTS TO INVESTMENT SEMINARS AND CUSTOMER INQUIRIES MADE IN RESPONSE TO A DEALER'S ADVERTISEMENTS – April 25, 1985~~

~~The Board recently has been asked about the application of rule G-19 on suitability to recommendations made during investment seminars or to recommendations made to customers responding to an~~

advertisement published by a dealer. As discussed earlier, rule G-19 prohibits a municipal securities professional from recommending transactions in municipal securities to a customer unless the professional makes certain determinations with respect to the suitability of the transactions.

The Board believes that rule G-19 applies to recommendations made by a professional at an investment seminar as follows: A dealer recommending a transaction in a particular security during the course of an investment seminar must have reasonable grounds for the recommendation in light of information about the security available from the issuer or otherwise. This duty applies to recommendations made generally to all participants in the seminar as well as to recommendations made to individual customers. In addition, a professional who makes a recommendation to a particular customer—whether during the course of the seminar or in response to an inquiry about purchasing the securities from the customer resulting from the customer's attendance at the seminar—must have reasonable grounds to believe and must believe that the recommendation is suitable for the customer in light of the customer's financial background, tax status, investment objectives and other similar information about the customer relevant to making a determination on suitability. If, after an inquiry by the professional, this information is not provided by the customer or otherwise known by the professional, the professional may make the recommendation only if he has no reasonable grounds to believe and does not believe that the recommendation is unsuitable for the particular customer.

The Board also wishes to advise the industry that the requirements of rule G-19 apply to recommendations made to customers who contact a dealer in response to an advertisement for municipal securities in the same way as they apply to all other recommendations made to customers.¹ As summarized above, if an individual contacts a dealer for additional information concerning municipal securities that were the subject of an advertisement, a professional is permitted to recommend a particular transaction to the individual only if he has reasonable grounds for recommending the security in light of information about the security available from the issuer or otherwise. Moreover, the professional may make the recommendation to the customer only if, after making a reasonable inquiry, he has reasonable grounds to believe and does believe that the recommendation is suitable for the customer on the basis of the financial and other information provided by the customer or obtained from other reliable sources.

¹ Rule G-21, on advertising, defines an advertisement as

any material (other than listings of offerings) published or designed for use in the public media, or any promotional literature designed for dissemination to the public, including any notice, circular, report, market letter, form letter or reprint or excerpt of the foregoing. The term does not apply to preliminary official statements or official statements, but does apply to abstracts or summaries of official statements, offering circulars and other such similar documents prepared by municipal securities brokers or municipal securities dealers.

* * * * *

Recommendations—February 17, 1998

Recommendations. This is in response to your letter in which you ask whether certain activities of [name deleted] (the "dealer") described in your letter constitute recommendations of municipal securities transactions to its customers within the meaning of Board rule G-19, on suitability of recommendations and transactions. In preparing this response, we have limited the scope of our review to the rules adopted by the Board, including rule G-19. You should consult with the Securities and Exchange Commission (the "SEC") for any interpretations of its Rule 15c2-12.¹

We agree with the SEC's statement that "most situations in which a broker, dealer or municipal securities dealer brings a municipal security to the attention of a customer involve an implicit recommendation of the security to the customer."² We also agree with the position taken by NASDR that "[w]hether a particular transaction is in fact recommended depends on an analysis of all the relevant facts and circumstances."³ Thus, the Board believes that, for purposes of rule G-19, a determination of whether a recommendation has been made under any particular set of facts and circumstances is dependent upon a close examination of such specific facts and circumstances. Such an inquiry is properly undertaken by the agencies charged with enforcing the Board's rules. *MSRB interpretation of February 17, 1998.*

¹ You have stated that staff of NASD Regulation, Inc. ("NASDR") found during an examination of the dealer "a failure to comply with MSRB Rule G-27(c), in that a review of written supervisory procedures indicated that the firm's procedures manual does not establish written procedures with respect to SEC Rule 15c2-12." To the extent that the dealer argues that its written supervisory procedures are not deficient under Board rule G-27 because it believes that it does not recommend any municipal securities to customers within the meaning of section (c) of SEC Rule 15c2-12, the dealer should, as noted above, consult with the SEC for an interpretation of the term "recommend" as used in its rule.

² Exchange Act Rel. No. 33742 (Mar. 9, 1994).

³ Letter dated January 23, 1997 from John M. Ramsey, Deputy General Counsel, NASDR, to Stuart J. Kaswell, Senior Vice President and General Counsel, Securities Industry Association.

* * * * *

Recommendations: advertisements—February 24, 1994

Recommendations: advertisements. This is in response to your letter in which you state that your firm is counsel to [name deleted] with regard to a certain issue of municipal securities. You note that, while the issue was in its planning stages, a solicitation for purchase of securities from the issue was distributed by a certain dealer without the knowledge or approval of the issuer. In addition, you state that the solicitation incorrectly indicated a date the issue was scheduled to be issued and incorrectly stated the term of the issue.

~~Rule G-21, on advertising, provides that no dealer shall publish or cause to be published any advertisement concerning municipal securities which such dealer knows or has reason to know is materially false or misleading. The rule defines advertisement as any material (other than listings of offerings) published or designed for use in the public media, or any promotional literature designed for dissemination to the public, including any notice, circular, report, market letter, form letter or reprint or excerpt of the foregoing.~~

~~On May 7, 1985, the Board released an interpretive notice concerning the application of suitability requirements to investment seminars and customer inquiries made in response to a dealer's advertisements.¹ In that notice the Board stated that the requirements of rule G-19, on suitability of recommendations and transactions, apply to recommendations made to customers who contact a dealer in response to an advertisement for municipal securities in the same way as they apply to all other recommendations made to customers. Under rule G-19, a dealer may make a recommendation only if the dealer has reasonable grounds, based upon information available from the issuer of the securities or otherwise, for recommending the security and, in addition, the dealer believes that the recommendation is suitable for the particular customer in light of the customer's financial background, tax status, and investment objectives and any other similar information concerning the customer known by the dealer.²~~

~~If an individual contacts a dealer for additional information concerning municipal securities that were the subject of any advertisement, a professional is permitted to recommend a particular transaction to the individual only if he has reasonable grounds for recommending the security in light of information about the security available from the issuer or otherwise. Moreover, the professional may make the recommendation to the customer only if, after making a reasonable inquiry, he has reasonable grounds to believe and does believe that the recommendation is suitable for the customer on the basis of the financial and other information provided by the customer or obtained from other reliable sources.~~

~~With respect to the advertisement in question, the fact that it includes an application form to be submitted by customers along with a check in purchasing securities from the issue would seem to indicate that the dealer was intending to effect transactions in the issue without undertaking a review of appropriate suitability determinations. A transaction effected in such a manner would be a violation of rule G-19. MSRB interpretation of February 24, 1994.~~

¹ ~~[See Rule G-19 Interpretation – Notice Concerning the Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer's Advertisements, May 7, 1985, reprinted in *MSRB Rule Book*.]~~

² ~~Rule G-8, on books and records, requires the information obtained about the customer to be recorded in the customer account record to assist in monitoring compliance with rule G-19. Dealers must ensure that these records are kept current if subsequent changes in the customer's position affect the suitability of recommendations made to the customer.~~

~~RESTATED INTERPRETIVE NOTICE REGARDING THE APPLICATION OF MSRB RULES TO TRANSACTIONS WITH SOPHISTICATED MUNICIPAL MARKET PROFESSIONALS—July 9, 2012~~

~~The MSRB’s fair practice rules allow dealers¹ to recognize the different capabilities of certain institutional customers as well as the varied types of dealer customer relationships. This interpretive notice concerns the manner in which a dealer determines that it has met certain of its fair practice obligations to certain institutional customers; it does not alter the basic duty to deal fairly, which applies to all transactions and all customers. For purposes of this notice, an “institutional customer” shall mean a customer with an “institutional account” as defined in Rule G-8(a)(xi).²~~

~~Sophisticated Municipal Market Professionals~~

~~For purposes of this notice, the term “sophisticated municipal market professional” or “SMMP” shall mean an institutional customer of a dealer that: (1) the dealer has a reasonable basis to believe is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions in municipal securities, and (2) affirmatively indicates that it is exercising independent judgment in evaluating the recommendations of the dealer. As part of the reasonable basis analysis required by clause (1), the dealer should consider the amount and type of municipal securities owned or under management by the institutional customer. A customer may make the affirmation required by clause (2) either orally or in writing and may provide the affirmation on a trade by trade basis, on a type-of municipal security basis (e.g., general obligation, revenue, variable rate, etc.), or for all potential transactions for the customer’s account.~~

~~While it is difficult to define in advance the scope of a dealer’s fair practice obligations with respect to a particular transaction, as will be discussed later, by making a reasonable determination that an institutional customer is an SMMP, certain of the dealer’s fair practice obligations remain applicable but are deemed fulfilled. In addition, as discussed below, the fact that a quotation is made by an SMMP would affect how such quotation is treated under Rule G-13.~~

~~Application of SMMP Concept to Rule G-17~~

~~The MSRB has interpreted Rule G-17 to require a dealer, in connection with any sale of municipal securities, to disclose to its customer, at or prior to the time of trade, all material information about the transaction known by the dealer, as well as material information about the security that is reasonably accessible to the market from established industry sources.³ A dealer must provide its customer with a complete description of the security, including a description of the features that would likely be considered significant by a reasonable investor and facts that are material to assessing the potential risks of the investment.⁴~~

~~However, when the dealer has reasonable grounds for concluding that the customer is an SMMP, the dealer’s obligation to ensure disclosure of material information available from established industry sources is fulfilled. There may be times when an SMMP is not satisfied that the information available from established industry sources is sufficient to allow it to make an informed investment decision. In those circumstances, the MSRB believes that an SMMP can recognize that risk and take appropriate action, by~~

declining to transact, undertaking additional investigation, or asking the dealer to undertake additional investigation.

This interpretation does nothing to alter a dealer's duty not to engage in deceptive, dishonest, or unfair practices under Rule G-17 or under the federal securities laws. In essence, a dealer's disclosure obligations to SMMPs would be on a par with inter-dealer disclosure obligations. This interpretation will be particularly relevant to dealers operating alternative trading systems, although it will also apply to other dealers.

As in the case of an inter-dealer transaction, in a transaction with an SMMP, a dealer's intentional withholding of a material fact about a security, when the information is not accessible through established industry sources, may constitute an unfair practice that violates Rule G-17. In addition, a dealer may not knowingly misdescribe securities to the customer. A dealer's duty not to mislead its customers is absolute and is not dependent upon the nature of the customer.

Application of SMMP Concept to Rule G-18

Rule G-18 provides that each dealer, when executing a transaction in municipal securities for or on behalf of a customer as agent, must make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions. The actions that must be taken by a dealer to make reasonable efforts to ensure that its non-recommended secondary market agency transactions with customers are effected at fair and reasonable prices may be influenced by the nature of the customer as well as by the services explicitly offered by the dealer.

If a dealer effects non-recommended secondary market agency transactions for SMMPs and its services have been explicitly limited to providing anonymity, communication, order matching, and/or clearance functions and the dealer does not exercise discretion as to how or when a transaction is executed, the MSRB believes the dealer is not required to take further actions on individual transactions to ensure that its agency transactions are effected at fair and reasonable prices. By making the determination that the customer is an SMMP, the dealer necessarily concludes that the customer has met the requisite high thresholds regarding capability of evaluating risks and market values, and undertaking of independent investment decisions that would help ensure the institutional customer's ability to evaluate whether a transaction's price is fair and reasonable.

This interpretation will be particularly relevant to dealers operating alternative trading systems in which SMMPs are permitted to participate. However, even though this interpretation eliminates a duty to evaluate each individual transaction price, a dealer operating such system, under the general duty set forth in Rule G-18, must act to investigate any alleged pricing irregularities on its system brought to its attention. Accordingly, a dealer may be subject to Rule G-18 violations if it fails to take actions to address system or participant pricing abuses.

If a dealer effects agency transactions for customers that are not SMMPs, or has held itself out to do more than provide anonymity, communication, matching and/or clearance services, or performs such services with discretion as to how and when the transaction is executed, it will be required to establish that it

exercised reasonable efforts to ensure that its agency transactions with customers are effected at fair and reasonable prices. Further, if a dealer engages in principal transactions with an SMMP, Rule G-30(a) applies and the dealer is responsible for a transaction-by-transaction review to ensure that it is charging a fair and reasonable price. In addition, Rule G-30(b) applies to the commission or service charges that a dealer operating an alternative trading system may charge to effect the agency transactions that take place on its system, even in connection with transactions with SMMPs for which no further action is required pursuant to this notice with respect to Rule G-18.

Application of SMMP Concept to Rule G-19

The MSRB's suitability rule is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct. Dealers' responsibilities include having a reasonable basis for recommending a particular security or strategy, as well as having reasonable grounds for believing the recommendation is suitable for the customer to whom it is made. Dealers are expected to meet the same high standards of competence, professionalism, and good faith regardless of the financial circumstances of the customer. Rule G-19, on suitability of recommendations and transactions, requires that, in recommending to a customer any municipal security transaction, a dealer shall have reasonable grounds for believing that the recommendation is suitable for the customer based upon information available from the issuer of the security or otherwise and based upon the facts disclosed by the customer or otherwise known about the customer.

This guidance concerns only the manner in which a dealer determines that a recommendation is suitable for a particular institutional customer. The manner in which a dealer fulfills this suitability obligation will vary depending on the nature of the customer and the specific transaction. Accordingly, this interpretation deals only with guidance regarding how a dealer will fulfill such "customer specific suitability obligations" under Rule G-19. This interpretation does not address the obligation related to suitability that requires that a dealer have a "reasonable basis" to believe that the recommendation could be suitable for at least some customers. In the case of a recommended transaction, a dealer may, depending upon the facts and circumstances, be obligated to undertake a more comprehensive review or investigation in order to meet its obligation under Rule G-19 to have a "reasonable basis" to believe that the recommendation could be suitable for at least some customers.⁵

The manner in which a dealer fulfills its "customer specific suitability obligations" will vary depending on the nature of the customer and the specific transaction. While it is difficult to define in advance the scope of a dealer's suitability obligation with respect to a specific institutional customer transaction recommended by a dealer, the MSRB has identified the factors that define an SMMP as factors that may be relevant when considering compliance with Rule G-19. Where the dealer has reasonable grounds for concluding that an institutional customer is an SMMP, then a dealer's obligation to determine that a recommendation is suitable for that particular customer is fulfilled.

This interpretation does not address the facts and circumstances that go into determining whether an electronic communication does or does not constitute a "recommendation."

~~Application of SMMP Concept to Rule G-13~~

~~Under Rule G-13, no dealer may distribute or publish, or cause to be distributed or published, any quotation relating to municipal securities, unless the quotation is *bona fide* (i.e., the dealer making the quotation is prepared to execute at the quoted price) and the price stated in the quotation is based on the best judgment of the dealer of the fair market value of the securities that are the subject of the quotation at the time the quotation is made. In general, any quotation disseminated by a dealer (including the quotation of an investor) is presumed to be a quotation made by the dealer and the dealer is responsible for ensuring compliance with the *bona fide* and fair market value requirements with respect to the quotation.⁶ However, if a dealer disseminates a quotation that is actually made by another dealer and the quotation is labeled as such, then the quotation is presumed to be a quotation made by such other dealer and not by the disseminating dealer. In such a case, the disseminating dealer is only required to have no reason to believe that either: (i) the quotation does not represent a *bona fide* bid for, or offer of, municipal securities by the maker of the quotation or (ii) the price stated in the quotation is not based on the best judgment of the maker of the quotation of the fair market value of the securities.~~

~~If an SMMP makes a “quotation” and it is labeled as such, then it is presumed not to be a quotation made by the disseminating dealer; rather, the dealer is held to the same standard as if it were disseminating a quotation made by another dealer.⁷ In either case, the disseminating dealer’s responsibility with respect to such quotation is reduced. Under these circumstances, the disseminating dealer must have no reason to believe that either: (i) the quotation does not represent a *bona fide* bid for, or offer of, municipal securities by the maker of the quotation or (ii) the price stated in the quotation is not based on the best judgment of the maker of the quotation of the fair market value of the securities.~~

~~While Rule G-13 does not impose an affirmative duty on the dealer disseminating quotations made by other dealers or SMMPs to investigate or determine the market value or *bona fide* nature of each such quotation, it does require that the disseminating dealer take into account any information it receives regarding the nature of the quotations it disseminates. Based on this information, such a dealer must have no reason to believe that these quotations fail to meet either the *bona fide* or the fair market value requirement and it must take action to address such problems brought to its attention. Reasons for believing there are problems could include, among other things, (i) complaints received from dealers and investors seeking to execute against such quotations, (ii) a pattern of a dealer or SMMP failing to update, confirm, or withdraw its outstanding quotations so as to raise an inference that such quotations may be stale or invalid, or (iii) a pattern of a dealer or SMMP effecting transactions at prices that depart materially from the price listed in the quotations in a manner that consistently is favorable to the party making the quotation.⁸~~

~~In a prior MSRB interpretation stating that stale or invalid quotations published in a daily or other listing must be withdrawn or updated in the next publication, the MSRB did not consider the situation where quotations are disseminated electronically on a continuous basis.⁹ In such case, the MSRB believes that the *bona fide* requirement obligates a dealer to withdraw or update a stale or invalid quotation promptly enough to prevent a quotation from becoming misleading as to the dealer’s willingness to buy or sell at the stated price. In addition, although not required under the rule, the MSRB believes that posting the~~

time and date of the most recent update of a quotation can be a positive factor in determining whether the dealer has taken steps to ensure that a quotation it disseminates is not stale or misleading.

¹ The term “dealer” is used in this notice as shorthand for “broker,” “dealer” or “municipal securities dealer,” as those terms are defined in the Securities Exchange Act of 1934 (the “Exchange Act”). The use of the term in this notice does not imply that the entity is necessarily taking a principal position in a municipal security.

² Rule G-8(a)(xi) defines “institutional account” as the account of (i) a bank, savings and loan association, insurance company, or registered investment company; (ii) an investment adviser registered either with the Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or (iii) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least \$50 million.

³ See, e.g., Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities (July 14, 2009); see also Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts (March 18, 2002).

⁴ The Supreme Court has stated that a fact is material when there is a “substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011); *Basic Inc. v. Levinson*, 485 U.S. 224 (1988); *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).

⁵ See MSRB Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts (March 18, 2002); see also MSRB Notice Regarding Application of Rule G-19, on Suitability of Recommendations and Transactions, to Online Communications (September 25, 2002).

⁶ A customer’s bid for, offer of, or request for bid or offer is included within the meaning of a “quotation” if it is disseminated by a dealer.

⁷ The disseminating dealer need not identify by name the maker of the quotation, but only that such quotation was made by another dealer or an SMMP, as appropriate.

⁸ The MSRB believes that, consistent with its view previously expressed with respect to “bait-and-switch” advertisements, a dealer that includes a price in its quotation that is designed as a mechanism to attract potential customers interested in the quoted security for the primary purpose of drawing such potential customers into a negotiation on that or another security, where the quoting dealer has no intention at the time it makes the quotation of executing a transaction in such security at that price, could be a violation of Rule G-17. See MSRB Rule G-21 Interpretive Letter—Disclosure Obligations (May 21, 1998).

⁹ See MSRB Notice of Interpretation of Rule G-13 on Published Quotations (April 21, 1988).

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~~INTERPRETIVE NOTICE REGARDING THE APPLICATION OF MSRB RULES TO TRANSACTIONS WITH SOPHISTICATED MUNICIPAL MARKET PROFESSIONALS – April 30, 2002~~

~~NOTE: THIS NOTICE IS SUPERSEDED BY THE RESTATED INTERPRETIVE NOTICE REGARDING THE APPLICATION OF MSRB RULES TO TRANSACTIONS WITH SOPHISTICATED MUNICIPAL MARKET PROFESSIONALS (JULY 9, 2012)~~

~~Industry participants have suggested that the MSRB's fair practice rules should allow dealers¹ to recognize the different capabilities of certain institutional customers as well as the varied types of dealer-customer relationships. Prior MSRB interpretations reflect that the nature of the dealer's counter party should be considered when determining the specific actions a dealer must undertake to meet its duty to deal fairly. The MSRB believes that dealers may consider the nature of the institutional customer in determining what specific actions are necessary to meet the fair practice standards for a particular transaction. This interpretive notice concerns only the manner in which a dealer determines that it has met certain of its fair practice obligations to certain institutional customers; it does not alter the basic duty to deal fairly, which applies to all transactions and all customers. For purposes of this interpretive notice, an institutional customer shall be an entity, other than a natural person (corporation, partnership, trust, or otherwise), with total assets of at least \$100 million invested in municipal securities in the aggregate in its portfolio and/or under management.~~

~~Sophisticated Municipal Market Professionals~~

~~Not all institutional customers are sophisticated regarding investments in municipal securities. There are three important considerations with respect to the nature of an institutional customer in determining the scope of a dealer's fair practice obligations. They are:~~

- ~~– Whether the institutional customer has timely access to all publicly available material facts concerning a municipal securities transaction;~~
- ~~– Whether the institutional customer is capable of independently evaluating the investment risk and market value of the municipal securities at issue; and~~
- ~~– Whether the institutional customer is making independent investment decisions about its investments in municipal securities.~~

~~When a dealer has reasonable grounds for concluding that an institutional customer (i) has timely access to the publicly available material facts concerning a municipal securities transaction; (ii) is capable of independently evaluating the investment risk and market value of the municipal securities at issue; and (iii) is making independent decisions about its investments in municipal securities, and other known facts do not contradict such a conclusion, the institutional customer can be considered a sophisticated municipal market professional ("SMMP"). While it is difficult to define in advance the scope of a dealer's fair practice obligations with respect to a particular transaction, as will be discussed later, by making a reasonable~~

determination that an institutional customer is an SMMP, then certain of the dealer's fair practice obligations remain applicable but are deemed fulfilled. In addition, as discussed below, the fact that a quotation is made by an SMMP would have an impact on how such quotation is treated under rule G-13.

Considerations Regarding The Identification Of Sophisticated Municipal Market Professionals

The MSRB has identified certain factors for evaluating an institutional investor's sophistication concerning a municipal securities transaction and these factors are discussed in detail below. Moreover, dealers are advised that they have the option of having investors attest to SMMP status as a means of streamlining the dealers' process for determining that the customer is an SMMP. However, a dealer would not be able to rely upon a customer's SMMP attestation if the dealer knows or has reason to know that an investor lacks sophistication concerning a municipal securities transaction, as discussed in detail below.

Access to Material Facts

A determination that an institutional customer has timely access to the publicly available material facts concerning the municipal securities transaction will depend on the customer's resources and the customer's ready access to established industry sources (as defined below) for disseminating material information concerning the transaction. Although the following list is not exhaustive, the MSRB notes that relevant considerations in determining that an institutional customer has timely access to publicly available information could include:

- the resources available to the institutional customer to investigate the transaction (e.g., research analysts);
- the institutional customer's independent access to the NRMSIR system,² and information generated by the MSRB's Municipal Securities Information Library[®] (MSIL[®]) system³ and Transaction Reporting System ("TRS"),⁴ either directly or through services that subscribe to such systems; and
- the institutional customer's access to other sources of information concerning material financial developments affecting an issuer's securities (e.g., rating agency data and indicative data sources).

Independent Evaluation of Investment Risks and Market Value

Second, a determination that an institutional customer is capable of independently evaluating the investment risk and market value of the municipal securities that are the subject of the transaction will depend on an examination of the institutional customer's ability to make its own investment decisions, including the municipal securities resources available to the institutional customer to make informed decisions. In some cases, the dealer may conclude that the institutional customer is not capable of independently making the requisite risk and valuation assessments with respect to municipal securities in general. In other cases, the institutional customer may have general capability, but may not be able to independently exercise these functions with respect to a municipal market sector or type of municipal security. This is more likely to arise with relatively new types of municipal securities and those with significantly different risk or volatility characteristics than other municipal securities investments generally.

made by the institution. If an institution is either generally not capable of evaluating investment risk or lacks sufficient capability to evaluate the particular municipal security, the scope of a dealer's fair practice obligations would not be diminished by the fact that the dealer was dealing with an institutional customer. On the other hand, the fact that a customer initially needed help understanding a potential investment need not necessarily imply that the customer did not ultimately develop an understanding and make an independent investment decision.

While the following list is not exhaustive, the MSRB notes that relevant considerations in determining that an institutional customer is capable of independently evaluating investment risk and market value considerations could include:

- the use of one or more consultants, investment advisers, research analysts or bank trust departments;
- the general level of experience of the institutional customer in municipal securities markets and specific experience with the type of municipal securities under consideration;
- the institutional customer's ability to understand the economic features of the municipal security;
- the institutional customer's ability to independently evaluate how market developments would affect the municipal security that is under consideration; and
- the complexity of the municipal security or securities involved.

Independent Investment Decisions

Finally, a determination that an institutional customer is making independent investment decisions will depend on whether the institutional customer is making a decision based on its own thorough independent assessment of the opportunities and risks presented by the potential investment, market forces and other investment considerations. This determination will depend on the nature of the relationship that exists between the dealer and the institutional customer. While the following list is not exhaustive, the MSRB notes that relevant considerations in determining that an institutional customer is making independent investment decisions could include:

- any written or oral understanding that exists between the dealer and the institutional customer regarding the nature of the relationship between the dealer and the institutional customer and the services to be rendered by the dealer;
- the presence or absence of a pattern of acceptance of the dealer's recommendations;
- the use by the institutional customer of ideas, suggestions, market views and information relating to municipal securities obtained from sources other than the dealer; and
- the extent to which the dealer has received from the institutional customer current comprehensive portfolio information in connection with discussing potential municipal securities transactions or has not

been provided important information regarding the institutional customer's portfolio or investment objectives.

Dealers are reminded that these factors are merely guidelines which will be utilized to determine whether a dealer has fulfilled its fair practice obligations with respect to a specific institutional customer transaction and that the inclusion or absence of any of these factors is not dispositive of the determination. Such a determination can only be made on a case-by-case basis taking into consideration all the facts and circumstances of a particular dealer/customer relationship, assessed in the context of a particular transaction. As a means of ensuring that customers continue to meet the defined SMMP criteria, dealers are required to put into place a process for periodic review of a customer's SMMP status.

Application of SMMP Concept to Rule G-17's Affirmative Disclosure Obligations

The SMMP concept as it applies to rule G-17 recognizes that the actions of a dealer in complying with its affirmative disclosure obligations under rule G-17 when effecting non-recommended secondary market transactions may depend on the nature of the customer. While it is difficult to define in advance the scope of a dealer's affirmative disclosure obligations to a particular institutional customer, the MSRB has identified the factors that define an SMMP as factors that may be relevant when considering compliance with the affirmative disclosure aspects of rule G-17.

When the dealer has reasonable grounds for concluding that the institutional customer is an SMMP, the institutional customer, by definition, is already aware, or capable of making itself aware of, material facts and is able to independently understand the significance of the material facts available from established industry sources.⁵ When the dealer has reasonable grounds for concluding that the customer is an SMMP then the dealer's obligation when effecting non-recommended secondary market transactions to ensure disclosure of material information available from established industry sources is fulfilled. There may be times when an SMMP is not satisfied that the information available from established industry sources is sufficient to allow it to make an informed investment decision. In those circumstances, the MSRB believes that an SMMP can recognize that risk and take appropriate action, be it declining to transact, undertaking additional investigation or asking the dealer to undertake additional investigation.

This interpretation does nothing to alter a dealer's duty not to engage in deceptive, dishonest, or unfair practices under rule G-17 or under the federal securities laws. In essence, a dealer's disclosure obligations to SMMPs when effecting non-recommended secondary market transactions would be on par with inter-dealer disclosure obligations. This interpretation will be particularly relevant to dealers operating electronic trading platforms, although it will also apply to dealers who act as order takers over the phone or in person.⁶ This interpretation recognizes that there is no need for a dealer in a non-recommended secondary market transaction to disclose material facts available from established industry sources to an SMMP customer that already has access to the established industry sources.⁷

As in the case of an inter-dealer transaction, in a transaction with an SMMP, a dealer's intentional withholding of a material fact about a security, where the information is not accessible through established industry sources, may constitute an unfair practice violative of rule G-17. In addition, a dealer

may not knowingly misdescribe securities to the customer. A dealer's duty not to mislead its customers is absolute and is not dependent upon the nature of the customer.

Application of SMMP Concept to Rule G-18 Interpretation—Duty to Ensure That Agency Transactions Are Effected at Fair and Reasonable Prices

Rule G-18 requires that each dealer, when executing a transaction in municipal securities for or on behalf of a customer as agent, make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions.⁸ The actions that must be taken by a dealer to make reasonable efforts to ensure that its non-recommended secondary market agency transactions with customers are effected at fair and reasonable prices may be influenced by the nature of the customer as well as by the services explicitly offered by the dealer.

If a dealer effects non-recommended secondary market agency transactions for SMMPs and its services have been explicitly limited to providing anonymity, communication, order matching and/or clearance functions and the dealer does not exercise discretion as to how or when a transaction is executed, then the MSRB believes the dealer is not required to take further actions on individual transactions to ensure that its agency transactions are effected at fair and reasonable prices.⁹ By making the determination that the customer is an SMMP, the dealer necessarily concludes that the customer has met the requisite high thresholds regarding timely access to information, capability of evaluating risks and market values, and undertaking of independent investment decisions that would help ensure the institutional customer's ability to evaluate whether a transaction's price is fair and reasonable.

This interpretation will be particularly relevant to dealers operating alternative trading systems in which participation is limited to dealers and SMMPs. It clarifies that in such systems rule G-18 does not impose an obligation upon the dealer operating such a system to investigate each individual transaction price to determine its relationship to the market. The MSRB recognizes that dealers operating such systems may be merely aggregating the buy and sell interest of other dealers or SMMPs. This function may provide efficiencies to the market. Requiring the system operator to evaluate each transaction effected on its system may reduce or eliminate the desired efficiencies. Even though this interpretation eliminates a duty to evaluate each transaction, a dealer operating such system, under the general duty set forth in rule G-18, must act to investigate any alleged pricing irregularities on its system brought to its attention. Accordingly, a dealer may be subject to rule G-18 violations if it fails to take actions to address system or participant pricing abuses.

If a dealer effects agency transactions for customers who are not SMMPs, or has held itself out to do more than provide anonymity, communication, matching and/or clearance services, or performs such services with discretion as to how and when the transaction is executed, it will be required to establish that it exercised reasonable efforts to ensure that its agency transactions with customers are effected at fair and reasonable prices.

Application of SMMP Concept to Rule G-19 Interpretation—Suitability of Recommendations and Transactions

The MSRB's suitability rule is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct. Dealers' responsibilities include having a reasonable basis for recommending a particular security or strategy, as well as having reasonable grounds for believing the recommendation is suitable for the customer to whom it is made. Dealers are expected to meet the same high standards of competence, professionalism, and good faith regardless of the financial circumstances of the customer. Rule G-19, on suitability of recommendations and transactions, requires that, in recommending to a customer any municipal security transaction, a dealer shall have reasonable grounds for believing that the recommendation is suitable for the customer based upon information available from the issuer of the security or otherwise and based upon the facts disclosed by the customer or otherwise known about the customer.

This guidance concerns only the manner in which a dealer determines that a recommendation is suitable for a particular institutional customer. The manner in which a dealer fulfills this suitability obligation will vary depending on the nature of the customer and the specific transaction. Accordingly, this interpretation deals only with guidance regarding how a dealer will fulfill such "customer specific suitability obligations" under rule G-19. This interpretation does not address the obligation related to suitability that requires that a dealer have a "reasonable basis" to believe that the recommendation could be suitable for at least some customers. In the case of a recommended transaction, a dealer may, depending upon the facts and circumstances, be obligated to undertake a more comprehensive review or investigation in order to meet its obligation under rule G-19 to have a "reasonable basis" to believe that the recommendation could be suitable for at least some customers.⁴⁰

The manner in which a dealer fulfills its "customer specific suitability obligations" will vary depending on the nature of the customer and the specific transaction. While it is difficult to define in advance the scope of a dealer's suitability obligation with respect to a specific institutional customer transaction recommended by a dealer, the MSRB has identified the factors that define an SMMP as factors that may be relevant when considering compliance with rule G-19. Where the dealer has reasonable grounds for concluding that an institutional customer is an SMMP, then a dealer's obligation to determine that a recommendation is suitable for that particular customer is fulfilled.

This interpretation does not address the facts and circumstances that go into determining whether an electronic communication does or does not constitute a "recommendation."

Application of SMMP Concept to Rule G-13, on Quotations

New electronic trading systems provide a variety of avenues for disseminating quotations among both dealers and customers. In general, except as described below, any quotation disseminated by a dealer is presumed to be a quotation made by such dealer. In addition, any "quotation" of a non-dealer (e.g., an investor) relating to municipal securities that is disseminated by a dealer is presumed, except as described below, to be a quotation made by such dealer.⁴¹ The dealer is affirmatively responsible in either case for

ensuring compliance with the bona fide and fair market value requirements with respect to such quotation.

However, if a dealer disseminates a quotation that is actually made by another dealer and the quotation is labeled as such, then the quotation is presumed to be a quotation made by such other dealer and not by the disseminating dealer. Furthermore, if an SMMP makes a “quotation” and it is labeled as such, then it is presumed not to be a quotation made by the disseminating dealer; rather, the dealer is held to the same standard as if it were disseminating a quotation made by another dealer.¹² In either case, the disseminating dealer’s responsibility with respect to such quotation is reduced. Under these circumstances, the disseminating dealer must have no reason to believe that either: (i) the quotation does not represent a bona fide bid for, or offer of, municipal securities by the maker of the quotation or (ii) the price stated in the quotation is not based on the best judgment of the maker of the quotation of the fair market value of the securities.

While rule G-13 does not impose an affirmative duty on the dealer disseminating quotations made by other dealers or SMMPs to investigate or determine the market value or bona fide nature of each such quotation, it does require that the disseminating dealer take into account any information it receives regarding the nature of the quotations it disseminates. Based on this information, such a dealer must have no reason to believe that these quotations fail to meet either the bona fide or the fair market value requirement and it must take action to address such problems brought to its attention. Reasons for believing there are problems could include, among other things, (i) complaints received from dealers and investors seeking to execute against such quotations, (ii) a pattern of a dealer or SMMP failing to update, confirm or withdraw its outstanding quotations so as to raise an inference that such quotations may be stale or invalid, or (iii) a pattern of a dealer or SMMP effecting transactions at prices that depart materially from the price listed in the quotations in a manner that consistently is favorable to the party making the quotation.¹³

In a prior MSRB interpretation stating that stale or invalid quotations published in a daily or other listing must be withdrawn or updated in the next publication, the MSRB did not consider the situation where quotations are disseminated electronically on a continuous basis.¹⁴ In such case, the MSRB believes that the bona fide requirement obligates a dealer to withdraw or update a stale or invalid quotation promptly enough to prevent a quotation from becoming misleading as to the dealer’s willingness to buy or sell at the stated price. In addition, although not required under the rule, the MSRB believes that posting the time and date of the most recent update of a quotation can be a positive factor in determining whether the dealer has taken steps to ensure that a quotation it disseminates is not stale or misleading.

¹ The term “dealer” is used in this notice as shorthand for “broker,” “dealer” or “municipal securities dealer,” as those terms are defined in the Securities Exchange Act of 1934. The use of the term in this notice does not imply that the entity is necessarily taking a principal position in a municipal security.

² For purposes of this notice, the “NRMSIR system” refers to the disclosure dissemination system adopted by the SEC in Rule 15c2-12. Under Rule 15c2-12, as adopted in 1989, participating underwriters provide a

copy of the final official statement to a Nationally Recognized Municipal Securities Information Repository (“NRMSIR”) to reduce their obligation to provide a final official statement to potential customers upon request. In the 1994 amendments to Rule 15c2-12 the Commission determined to require that annual financial information and audited financial statements submitted in accordance with issuer undertakings must be delivered to each NRMSIR and to the State Information Depository (“SID”) in the issuer’s state, if such depository has been established. The requirement to have annual financial information and audited financial statements delivered to all NRMSIRs and the appropriate SID was included in Rule 15c2-12 to ensure that all NRMSIRs receive disclosure information directly. Under the 1994 amendments, notices of material events, as well as notices of a failure by an issuer or other obligated person to provide annual financial information, must be delivered to each NRMSIR or the MSRB, and the appropriate SID.

³ The MSIL[®] system collects and makes available to the marketplace official statements and advance refunding documents submitted under MSRB rule G-36, as well as certain secondary market material event disclosures provided by issuers under SEC Rule 15c2-12. Municipal Securities Information Library[®] and MSIL[®] are registered trademarks of the MSRB.

⁴ The MSRB’s TRS collects and makes available to the marketplace information regarding inter-dealer and dealer-customer transactions in municipal securities.

⁵ The MSRB has filed a related notice regarding the disclosure of material facts under rule G-17 concurrently with this filing. See SEC File No. SR-MSRB-2002-01. The MSRB’s rule G-17 notice provides that a dealer would be responsible for disclosing to a customer any material fact concerning a municipal security transaction (regardless of whether such transaction had been recommended by the dealer) made publicly available through sources such as the NRMSIR system, the MSIL[®] system, TRS, rating agency reports and other sources of information relating to the municipal securities transaction generally used by dealers that effect transactions in municipal securities (collectively, “established industry sources”).

⁶ For example, if an SMMP reviewed an offering of municipal securities on an electronic platform that limited transaction capabilities to broker-dealers and then called up a dealer and asked the dealer to place a bid on such offering at a particular price, the interpretation would apply because the dealer would be acting merely as an order taker effecting a non-recommended secondary market transaction for the SMMP.

⁷ In order to meet the definition of an SMMP an institutional customer must, at least, have access to established industry sources.

⁸ This guidance only applies to the actions necessary for a dealer to ensure that its agency transactions are effected at fair and reasonable prices. If a dealer engages in principal transactions with an SMMP, rule G-30(a) applies and the dealer is responsible for a transaction-by-transaction review to ensure that it is charging a fair and reasonable price. In addition, rule G-30(b) applies to the commission or service charges that a dealer operating an electronic trading system may charge to effect the agency transactions that take place on its system.

⁹ Similarly, the MSRB believes the same limited agency functions can be undertaken by a broker's broker toward other dealers. For example, if a broker's broker effects agency transactions for other dealers and its services have been explicitly limited to providing anonymity, communication, order matching and/or clearance functions and the dealer does not exercise discretion as to how or when a transaction is executed, then the MSRB believes the broker's broker is not required to take further actions on individual transactions to ensure that its agency transactions with other dealers are effected at fair and reasonable prices.

¹⁰ See e.g., Rule G-19 Interpretation—Notice Concerning the Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer's Advertisement, May 7, 1985, *MSRB Rule Book* (July 1, 2001) at 135; *In re F.J. Kaufman and Company of Virginia*, 50 S.E.C. 164, 168, 1989 SEC LEXIS 2376, *10 (1989). The SEC, in its discussion of municipal underwriters' responsibilities in a 1988 Release, noted that "a broker-dealer recommending securities to investors implies by its recommendation that it has an adequate basis for the recommendation." *Municipal Securities Disclosure*, Securities Exchange Act Release No. 26100 (September 22, 1988) (the "1988 SEC Release") at text accompanying note 72.

¹¹ A customer's bid for, offer of, or request for bid or offer is included within the meaning of a "quotation" if it is disseminated by a dealer.

¹² The disseminating dealer need not identify by name the maker of the quotation, but only that such quotation was made by another dealer or an SMMP, as appropriate.

¹³ The MSRB believes that, consistent with its view previously expressed with respect to "bait and switch" advertisements, a dealer that includes a price in its quotation that is designed as a mechanism to attract potential customers interested in the quoted security for the primary purpose of drawing such potential customers into a negotiation on that or another security, where the quoting dealer has no intention at the time it makes the quotation of executing a transaction in such security at that price, could be a violation of rule G-17. See Rule G-21 Interpretive Letter—Disclosure obligations, *MSRB interpretation of May 21, 1998*, *MSRB Rule Book* (July 1, 2001) at p. 139.

¹⁴ See Rule G-13 Interpretation, Notice of Interpretation of Rule G-13 on Published Quotations, April 21, 1988, *MSRB Rule Book* (July 1, 2001) at 91.

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MSRB ANSWERS FREQUENTLY ASKED QUESTIONS REGARDING DEALER DISCLOSURE OBLIGATIONS UNDER MSRB RULE G-17—November 30, 2011

BACKGROUND

On September 20, 2010, the MSRB and FINRA issued reminder notices to brokers, dealers and municipal securities dealers ("dealers") of their sales practice obligations when selling municipal securities in the secondary market (the "2010 Notices").¹ The 2010 Notices reiterate MSRB interpretive guidance issued to

dealers in prior years, including MSRB Notices 2002-10 (the “2002 Notice”) and 2009-42 (the “2009 Notice”), which were filed with the Securities and Exchange Commission (“SEC”).² –

Since the issuance of the 2010 Notices, dealers have raised questions regarding the Notices and their obligations to customers in secondary market transactions of municipal securities. Consequently, the MSRB has prepared the following answers to the most frequently asked questions about those obligations, which apply equally to primary market transactions with customers. –

What is the basis for a dealer’s fair dealing obligation under MSRB Rules?

MSRB Rule G-17 sets forth the basic customer protection obligation of dealers when executing municipal securities transactions with or on behalf of customers. It provides that, in the conduct of its municipal securities activities, each dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice. The rule contains an anti-fraud provision, and a general duty to deal fairly, even in the absence of fraud.³

What disclosures must a dealer provide to customers?

A dealer must disclose, at or prior to the sale of municipal securities to a customer, all material information about the transaction known by the dealer, as well as material information about the security that is reasonably accessible to the market.⁴ Information available from “established industry sources” is deemed to be reasonably accessible to the market.⁵ In the case of Sophisticated Municipal Market Professionals (“SMMPPs”), the disclosure obligation may be deemed satisfied if a dealer complies with certain requirements established by the MSRB in prior guidance.⁶

When must a dealer disclose material information to a customer?

A dealer must disclose material information about the security or transaction at or prior to the time of sale to a customer.⁷ This obligation includes a duty to give the customer a complete description of the security, including a description of the features that likely would be considered significant by a reasonable investor and facts that are material to assessing the potential risks of the investment.⁸

What is an “established industry source?”

The MSRB has defined an established industry source as a source of information relating to municipal securities transactions generally used by dealers that effect transactions in the type of municipal securities at issue.⁹ The MSRB has previously indicated that sources such as rating agency reports¹⁰ and the MSRB’s Electronic Municipal Market Access (“EMMA”) system¹¹ are considered to be “established industry sources.” These sources are not the only “established industry sources.” Rather, the MSRB has noted that information vendors and other organizations may provide industry professionals with access to information that is generally used by dealers to effect transactions in municipal securities.¹² The MSRB expects that, as technology evolves and municipal securities information becomes more readily available, new “established industry sources” are likely to emerge. Moreover, the sources of information used by dealers that effect transactions in municipal securities may vary with the type of municipal security.¹³ For this reason, the MSRB has indicated that a dealer might draw on fewer industry sources to disclose all material information about a “triple-A” rated general obligation bond than for a non-rated conduit issue.¹⁴ Conversely, to the extent that a security is more complex, for example because of complex structure or where credit quality is changing rapidly, a dealer might need to take into account a broader range of

information sources prior to executing a transaction.¹⁵ Each dealer must determine the range of information sources it will use to obtain material information regarding a particular municipal security.

What is material information?

In general, information is considered “material” if there is a substantial likelihood that the information would be considered important or significant by a reasonable investor in making an investment decision.¹⁶ The scope of material information that dealers are obligated to disclose to their customers is not limited solely to information made available through established industry sources.¹⁷ Dealers also must disclose material information they know about the securities even if such information is not then available from established industry sources.¹⁸ —

Must a dealer disclose material information to the customer even if the dealer is not recommending the municipal security to the customer?

Yes. Even where the customer is placing an “unsolicited order” and the dealer is acting as a “mere order taker,” the dealer has the same fair dealing obligation to disclose all material information to the customer regarding the security and the transaction.¹⁹

Must a dealer use search engines and other internet tools to locate all material information regarding the municipal security at issue?

While dealers may choose to use search engines and other internet tools in their material information inquiries, they are not obligated to do so. As the MSRB stated in 2002, the level of inquiry performed by a dealer may vary based on the nature of the security.²⁰ A dealer might, for example, choose to conduct a search using an internet search engine or to use other tools when the issue is unrated or unfamiliar to the dealer. The MSRB does not mandate a particular level of inquiry by dealers. Rather, each dealer must determine the scope of its own inquiry as may be necessary to meet its obligations as a marketplace professional. As the MSRB stated in the 2009 Notice, “as professionals in the marketplace, dealers use a combination of internal resources and public and proprietary information sources to obtain the information necessary to conduct their business in a professional manner and to meet their disclosure and fair practice duties to investors.”

Do dealers who sell municipal securities to customers using electronic platforms have the same fair dealing and disclosure obligations as other dealers?

Yes. Dealers are subject to the fair dealing and disclosure obligations under MSRB Rule G-17, regardless of the manner in which the customer purchases the municipal security.²¹ Dealers operating electronic trading or brokerage systems have the same obligations to disclose material information as other dealers.²² The MSRB has noted that the provision of electronic access to material information to customers who elect to transact in municipal securities on an electronic platform is generally consistent with a dealer’s obligation to disclose such information, but whether such access is effective disclosure for purposes of meeting the disclosure obligation under MSRB Rule G-17 ultimately depends upon the particular facts and circumstances present.²³

What are the supervisory obligations of dealers regarding the fair dealing and disclosure obligations under MSRB Rule G-17?

Under MSRB Rule G-27, dealers must supervise their municipal securities business and ensure they have

~~adequate policies and procedures in place to monitor the effectiveness of their supervisory systems.²⁴ - They must supervise the municipal securities activities of their associated persons, have adequate written supervisory procedures, and implement supervisory controls to ensure their supervisory procedures are adequate.²⁵ - Importantly, dealers must implement processes to ensure that material information regarding municipal securities is disseminated to their registered representatives who are engaged in sales to and from customers. It would be insufficient for a dealer to possess such material information, if there were no means by which a registered representative could access it and provide such information to customers.~~

~~Questions about this Notice should be directed to Lawrence P. Sandor, Senior Associate General Counsel at (703) 797-6600.~~

~~November 30, 2011~~

¹~~-See MSRB Notice 2010-37 (September 20, 2010); FINRA Regulatory Notice 10-41 (September 20, 2010).~~

²~~-See MSRB Notice 2009-42 (July 14, 2009); MSRB Notice 2002-10 (March 25, 2002).~~

³~~-See 2009 Notice.~~

⁴~~-Id.~~

⁵~~-Id.~~

⁶~~-See MSRB Notice 2002-16 (May 6, 2002). All other references herein to customers pertain to non-SMMPs.~~

⁷~~-The time of sale, sometimes referred to as the "time of trade," is when the investor and the dealer agree to make the trade. -See 2009 Notice.~~

⁸~~-Id.~~

⁹~~-See 2002 Notice.~~

¹⁰~~-Id.~~

¹¹~~-See 2009 Notice.~~

¹²~~-See 2002 Notice; 2009 Notice.~~

¹³~~-See 2002 Notice.~~

¹⁴~~-Id.~~

¹⁵~~-Id.~~

¹⁶ ~~See 2009 Notice.~~

¹⁷ ~~Id.~~

¹⁸ ~~Id.~~

¹⁹ ~~Id.~~

²⁰ ~~See 2002 Notice.~~

²¹ ~~Id.~~

²² ~~Id.~~

²³ ~~Id.~~

²⁴ ~~See MSRB Rule G-27.~~

²⁵ ~~Id.~~

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~~APPLICATION OF MSRB RULES TO TRANSACTIONS IN AUCTION RATE SECURITIES—February 19, 2008~~

~~Recent downgrades of municipal bond insurers and other short term liquidity concerns have created extreme volatility in the market for municipal Auction Rate Securities. There also have been an unprecedented number of “failed auctions,” meaning that investors who chose to liquidate their positions through the auction process were not able to do so. This situation may result in existing investors selling Auction Rate Securities and investors unfamiliar with the product buying the securities. The MSRB is publishing this notice to remind brokers, dealers and municipal securities dealers (“dealers”) of the application of MSRB disclosure and suitability requirements that apply to all customer transactions in municipal Auction Rate Securities whether in primary offerings, at subsequent auctions, or in non-auction transactions.~~

~~AUCTION RATE SECURITIES~~

~~Auction Rate Securities are municipal securities with a variable interest rate that is set periodically through a “Dutch Auction” process.¹ An auction program employs one or more dealers (“Program Dealers”)² that solicit orders from investors who wish to own the securities over the next interest rate reset period. Interest rate reset periods normally are either 7, 28, or 35 days. The programs require one “Auction Agent”—typically a bank—that receives orders from the Program Dealer(s) and conducts auctions in accordance with the procedure described in program documents. This procedure is used to determine the lowest interest rate at which all of the securities that have been offered for sale by current holders of the securities will clear the market (the “clearing rate”). The clearing rate then becomes the interest rate for all of the securities in the issue for the next interest rate reset period. The Auction Agent provides the results~~

of the auction to the Program Dealer(s), and these dealers inform their bidders of the auction results and the securities, if any, that have been allocated to them as a result of the auction.

The official documents for Auction Rate Securities contain specific procedures to set interest rates for the upcoming interest period. The documents typically set an “all hold” rate that will apply when all existing holders are willing to hold at any rate.³ The documents also define situations under which a “maximum rate” is used for the next interest rate period. A maximum rate is used when the Auction Agent does not receive enough bids to cover the aggregate amount of securities that are put up for auction, or if the clearing rate of the auction would be above the maximum rate defined in program documents. This situation is commonly called a “failed auction.” As defined in the program documents, the maximum rate may be a multiple of a specified index or a fixed rate. The maximum rate set in a specific situation also may be dependent on other factors, such as the rating of the securities at the time of the auction.⁴

Auction Rate Securities historically have been sold to investors seeking short term, liquid investments and consequently are often insured as to payment of interest and principal by bond insurers. Recent downgrades of several major bond insurers have created concerns about insured municipal bonds and have spurred liquidity concerns that have seriously affected the market for Auction Rate Securities.

APPLICATION OF MSRB RULES ON DISCLOSURE AND SUITABILITY

The MSRB is aware that Auction Rate Securities are often sold to individual investors, who may not have the same sophistication as institutional customers in understanding the features of complex securities. It is therefore particularly important for dealers to focus attention on the application of MSRB investor protection rules when effecting transactions in Auction Rate Securities. The application of two important investor protection rules—Rule G-17 on fair practice and Rule G-19 on suitability of recommendations—is summarized below as a reminder of existing requirements.⁵

MSRB Rule G-17 requires dealers to deal fairly with all persons and prohibits deceptive, dishonest, or unfair practices. A longstanding interpretation of Rule G-17 is that a dealer transacting with a customer⁶ must ensure that the customer is informed of all material facts concerning the transaction, including a complete description of the security.⁷ Disclosure of material facts to a customer under Rule G-17 may be made orally or in writing, but must be made at or prior to the time of trade. In general, a fact is considered “material” if there is a substantial likelihood that its disclosure would have been considered significant by a reasonable investor.⁸

The duty to disclose material facts to a customer in an Auction Rate Securities transaction includes the duty to give a complete description of the security, including features of the auction process that likely would be considered significant by a reasonable investor. Given the variety and complexity of Auction Rate Securities, there are a number of facts that may fall within this duty to disclose, including the duration of the interest rate reset period, information on how the “all hold” and maximum rates are determined, and other features of the security found in the official documents of the issue.⁹ In light of recent events, it may be a material fact for an investor that an Auction Rate Security recently was subject to a failed auction.¹⁰ Of course, this does not represent an exhaustive list of facts that a dealer must consider as potentially material, since this may vary with individual securities and transactions.

Dealers also should carefully focus on the application of MSRB Rule G-19 on the suitability of recommendations when making recommendations to customers in Auction Rate Securities. Rule G-19 provides that a dealer must consider the nature of the security as well as the customer's financial status, tax status and investment objectives, based upon the facts disclosed by or otherwise known about the customer when making recommendations to customers. The dealer then must have reasonable grounds for believing that the recommendation is suitable for that customer.¹¹ Thus, among other factors, a dealer must consider both the liquidity characteristics of an Auction Rate Security and the customer's need for a liquid investment when making a suitability determination involving Auction Rate Securities.

¹ Unlike other short-term municipal securities with long-term maturity dates and short-term interest rate reset periods, such as Variable Rate Demand Obligations (VRDOs), Auction Rate Securities generally do not have "put" features or liquidity facilities that allow holders to tender their securities back to an issuer-appointed representative on a periodic basis.

² The Program Dealer(s) is so designated through an agreement with an auction agent and the Issuer of the Auction Rate Security.

³ The "all hold" rate typically is set by reference to a short-term market index.

⁴ In recent auctions, maximum rates have ranged from as low as 3% to as high as 20%. It should be noted that a failed auction is not an event of default by the issuer, it only relates to the auction process not being able to determine a clearing rate and not permitting investors attempting to sell their securities from being able to do so in the auction process.

⁵ A dealer's specific requirements under Rules G-17 and G-19 may be affected by the status of a customer as a Sophisticated Municipal Market Professional ("SMMP"). See *Bond Insurance Ratings—Application of MSRB Rules*, MSRB Notice 2008-04 (January 22, 2008). See also *Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals* (April 30, 2002). This current notice (MSRB Notice 2008-08) focuses on a dealer's duty when transacting with a customer that is not a SMMP.

⁶ The word "customer," as used in this notice, follows the definition in MSRB Rule D-9, which states that a "customer" is 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.

⁷ See, e.g., *Notice Concerning Disclosure of Call Information to Customers of Municipal Securities* (March 4, 1986), *MSRB Manual (CCH)* ¶ 3591.

⁸ See, e.g., *Basic v. Levinson* 485 U.S. 224 (1988).

⁹ ~~If the maximum rate is a formula linked to a particular securities market indicator, such as the London Interbank Offered Rate (LIBOR), the dealer's disclosure obligations may extend to a description of the material facts concerning the market indicator, as they relate to the Auction Rate Security.~~

¹⁰ ~~In a recent notice, the MSRB also reminded dealers that information about bond insurance and underlying credit ratings may constitute material facts about a transaction that must be disclosed under Rule G-17. See Bond Insurance Ratings — Application of MSRB Rules, MSRB Notice 2008-04 (January 22, 2008).~~

¹¹ ~~In the case when a low maximum rate is set for failed auctions, there may be a high likelihood for continued failed auctions. In this case, dealers should consider the non-auction secondary market prices when recommending to a customer whether to purchase the Auction Rate Security through an auction or in the non-auction secondary market.~~