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*Invested in America*

September 12, 2011

Mr. Richard G. Ketchum
Chairman and Chief Executive Officer
Financial Industry Regulatory Authority
1735 K Street NW
Washington, DC, 20006

Dear Chairman Ketchum:

The Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunities it has to work with the Securities and Exchange Commission (the "Commission" or "SEC"), the Municipal Securities Rulemaking Board ("MSRB" or the "Board") and the Financial Industry Regulatory Authority ("FINRA") in promoting the integrity and health of our financial markets. In this spirit during your meeting with our Municipal Executive Committee, we raised with you our concerns regarding FINRA Regulatory Notice 10-41.[1] In the same spirit, you invited us to work with you to develop a series of Frequently Asked Questions ("FAQs") addressing the concerns. We are pleased to accept this invitation and set out our concerns below in this letter as well as attach a set of FAQs we believe resolves them.

Much of the guidance provided in FINRA 10-41 is in our view both impracticable and exceeds the requirements imposed upon brokers, dealers, and municipal securities dealers ("Dealers") by the MSRB. FINRA 10-41 sets municipal market regulation to a point even more rigorous than that first proposed and then rejected by the SEC as text for Rule 15c2-12(c) when creating the framework for municipal secondary market disclosure in 1994 and may very well produce the damage to municipal market liquidity the Commission then determined to avoid.[2] In 1994, the fears that the transaction—by—transaction requirements of the proposing release would harm secondary market liquidity were raised cross-market by issuers and investors as well as Dealers. Today such unintended consequences of liquidity loss could potentially harm the same individual investors FINRA 10-41 seeks to benefit and possibly diminish their

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1 Regulatory Notice 10-41, FINRA Reminds Firms of Their Sales Practice and Due Diligence Obligations When Selling Municipal Securities in the Secondary Market, ("FINRA 10-41") available at: http://www.finra.org/Industry/Regulation/Notices/2010/P122113 (Sep. 20, 2010).

2 See SEC Release No. 34-34961 (Nov. 10, 1994).

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appetite for initial offerings as well, thereby hurting municipal issuers as well as investors. A shift in approach among FINRA examiners from a "may" to a "must" approach increases such concerns.

## I. Introduction

In September 2010, FINRA released Regulatory Notice 10-41, advising Dealers that in meeting their disclosure, suitability and pricing obligations under MSRB Rules G-17, G-19, and G-30, "firms must take into account all material information that is known to the firm or that is available through 'established industry sources,' including official statements, continuing disclosures, and trade data, much of which is now available through EMMA. Resources outside of EMMA may include press releases, research reports and other data provided by independent sources."[3]

The web page display of FINRA 10-41 links to a document titled "Municipal Bond Sales in the Secondary Market Checklist for Customer Disclosure" ("Checklist") advising "MSRB Rule G-17 requires you to disclose all 'material *information*' about the security, which includes not only continuing disclosures but information available from other sources, as described below."[4] Most notably, under "Established Industry Sources," the Checklist states "you may need to review other established industry sources, such as press releases, research reports, and other data provided by independent sources, (e.g., Bloomberg, search engines, local newspapers) to ensure that you have the material information relevant to your proposed transaction."[5] Under "Information Sources Consulted," the Checklist instructs: "note information you or your firm used in preparation for this sale" and includes under "Industry Sources" Bloomberg, search engines, local newspapers, and "other," with the instruction to attach copies of relevant information.[6] The Checklist calls for statement of customer name, registered representative name, bonds discussed, date and initials, clearly requiring a transaction-by-transaction record that has no support in any MSRB record-keeping rule or rule interpretation. As we explain below, the measures called for by FINRA 10-41 and the Checklist do not come within published MSRB rulemaking.

The MSRB has substantially expanded the scope of information to be disclosed in municipal transactions "if reasonably available from established industry sources" since its first use of the term "established industry sources" in

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3 FINRA 10-41.

4 Checklist available at link provided in n. 1, supra.

5 *Id.,* at 3.

6 *Id.*

2002.[7] This expansion, combined with the additional expansion of FINRA 10-41 and the Checklist, requires an impractical amount of work before each trade. We discuss this concern below under the heading ***Established Industry Sources***.

Our concerns about FINRA 10-41 continue with the observation that by expressly directing Dealers to internet search engines without limitation or qualification, FINRA leads Dealers to a potentially bottomless pit of untested and unreliable information and a compliance task without any meaningful limitation of reasonableness. According to the MSRB, "there are approximately 60,000 different issuers of municipal securities, and many of these issuers may issue different types of securities."[8] The bonds of a municipal issuer may have a variety of differing credit structures and within a bond issue, further divide into serial and term maturities. The resulting complexity of differing issuers and credits is demonstrated by the approximately 1.2 million individual CUSIPs in the municipal market. If tied to non-recommended as well as recommended transactions, the combination of potential issues of municipal securities covered together with such a search expectation produces a compliance task that is truly Sisyphean in its nature. Our concern is heightened by reports from some of our members that FINRA inspections appear already to be turning the "may" used in FINRA 10-41 and the Checklist into "must."

We are concerned that FINRA's listing of "press releases, research reports, and other data provided by independent sources, (e.g., Bloomberg, search engines, local newspapers)" as "established industry sources" goes beyond the meaning given to that term by MSRB rulemaking. No MSRB interpretation or other rulemaking precedes FINRA's use of this description. We discuss this concern below under the heading ***Impracticable Requirement without Limitation***.

We note that FINRA's own Rule 2114 (Recommendations to Customers in OTC Equity Securities) provides a useful contrast to MSRB interpretations under Rule G-17, even without the expansive treatment of FINRA 10-41, illustrating the disproportionate burden placed upon Dealers compared to other markets. We discuss this concern under the heading ***OTC Equity Securities in Contrast***.

Finally, we point out that in the 1994 amendments to SEC Rule 15c2-12, the Commission recognized the importance of avoiding an adverse impact to

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7 *See* Rule G-17 Interpretation – Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, *reprinted in* MSRB Rule Book (the "2002 Disclosure Notice"). We have parallel concerns about the manner of this expansion, which most recently has occurred with little opportunity for meaningful input from the market.

8 MSRB EMMA Education Center, at: http://emma.msrb.org/educationcenter/WhatAreBonds.aspx.

liquidity in the fragile market for municipal securities and wisely scaled back the contemplated requirements in recommended transactions under Rule 15c2-12(c). FINRA 10-41 and the Checklist almost certainly go beyond the line the Commission determined not to cross, as the MSRB may have done as well through its expansive interpretation of G-17. As a result, FINRA and the MSRB may be creating the very conditions harmful to municipal market liquidity the Commission sought to avoid. We discuss this concern below under ***1994 Amendments to Rule 15c2-12 and Concern for Market Liquidity***.

## II. Established Industry Sources

The MSRB introduced the term "established industry sources" in March 2002.[9] As the MSRB then explained, "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')."[10]

In other words, the MSRB interprets G-17 to require a Dealer to disclose material facts about a security: (a) that it knows, together with (b) those that "are reasonably accessible to the market." The MSRB then explains "reasonably accessible to the market" as "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" and defines these sources as "established industry sources." This is not a universe of material facts without limit; rather, it is limited to those "reasonably accessible to the market" including the systems created by the SEC and MSRB (NRMSIRs, MSIL® and TRS, now replaced by or incorporated into EMMA) and those "generally used by dealers that effect transactions in the type of municipal securities at issue."

As the MSRB explained in the SEC filing for the March 2002 proposed rule change introducing the term "established industry sources," the Board opined that it would "clarify that a dealer's general obligations to provide disclosure about a municipal security is viewed within the context of reasonably available information about the municipal security and the dealer's actual knowledge of the

[9] 2002 Disclosure Notice.

[10] *Id, See also* MSRB Notice 2009-42 (July 14, 2009).

municipal security."[11] The Board stated: "…the MSRB believes that the sources listed as established industry sources remain the predominant public sources of municipal securities information. Moreover, the definition of 'established industry sources' was deliberately drafted to include additional sources that may be developed for certain securities. Likewise, if any of the listed sources of information become less relevant to the market in the future, the MSRB can make specific note of it at the time."[12]

The Board carefully drafted the term established industry sources, with any change to the listed sources of information to be specifically made by the Board. Consistent with this approach, the Board has specifically noted the advent of EMMA in subsequent interpretation of G-17.[13] However, the Board has made no mention, specific or otherwise, of the "Bloomberg, search engines, local newspapers" characterized by FINRA as "established industry sources" in its Checklist. FINRA's attempt to treat these independent sources as established industry sources has no precedent in MSRB rulemaking or interpretation.[14] These are not the sort of "additional sources … developed for certain securities" that the Board "deliberately drafted" the term established industry sources to include. Moreover, while the Board has said "resources outside EMMA ***may***" include press releases, research reports and other data provided by independent sources," the Board has stopped short of requiring their review by municipal dealers. FINRA has, perhaps, exceeded existing MSRB interpretation in FINRA 10-41 and the Checklist as well as its own authority.[15]

## III. Impracticable Requirement without Limitation

According to the MSRB, "a dealer's general obligation to provide disclosure about a municipal security is viewed within the context of reasonably available information about the municipal security."[16] The terms "search engines" and "local newspapers" introduced by FINRA in the Checklist however,

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11 Release No. 34-45361, 67 F.R. 6562, 6564 (Feb. 12, 2002).

12 *Id*.

13 MSRB Notice 2009-42 (July 14, 2009).

14 In a "reminder to dealers" issued on the same day as FINRA 10-41, the MSRB did state: "[r]esources outside of EMMA ***may*** include press releases, research reports and other data provided by independent sources (*emphasis added).*" MSRB Notice 2010-37 MSRB Reminds Firms of their Sales Practice and Due Diligence Obligations when Selling Municipal Securities, (September 20, 2010). Although the MSRB described the notice as a "reminder", the Board appears never to have used the phrase before in its interpretation of the term "established industry sources" or Rule G-17. The notice was issued without posting for comment to the market and so the market has had no opportunity to comment on the scope or meaning of the phrase, the reasonableness of the requirement and the associated cost burdens of compliance.

15 The MSRB, it should be remembered, and not FINRA has authority to interpret MSRB rules. Securities Exchange Act of 1934 Section 15B(b)(2).

16 67 F.R. 6564.

are not "additional sources that may be developed for certain securities" of the sort the term "established industry sources" was "deliberately drafted" to include by the MSRB.[17] "Search engines," for example, captures a universe without limit of information that may vary in result from engine to engine and search to search, as well as time of search as search algorithms change. As results may differ, which one(s) should a Dealer use? "Local newspapers" is similarly open-ended: does it include all local newspapers, or those with a national focus; what about those available on line; those that report financial and political news, or opinion as well; and are blogs included? Resources so vaguely defined and open-ended cannot qualify as "generally used by dealers." Rather than assure provision of accurate material information to investors, these loosely-described sources are more likely to generate different results from Dealer to Dealer and confusion and misinformation among investors.[18]

Information gathered from such sources may not come from or even be known to the issuer of municipal securities, or may be a distortion of information otherwise produced by the issuer. In contrast, Rule 15c2-12 creates a framework of issuer-generated information to be reviewed by a Dealer in forming its reasonable basis when making a recommendation – a "deemed final" official statement in the case of underwritings and periodic disclosure under a continuing disclosure agreement. Likewise, when adopting the continuing disclosure amendments to Rule 15c2-12, the SEC called attention to its shared view with the MSRB that the MSRB fair dealing and suitability rules as well as the antifraud provisions look to "issuer publicized" information.[19] One may well question whether a reasonably prudent broker-dealer would disclose every news article and blog post that an internet search would reveal, even though they may contain information that a reasonable investor would want to know. There is often no way to test the veracity of the statements in these sources, and it seems contrary to the stated purposes of Rule G-17—investor protection—to provide information to investors from questionable sources. Both FINRA 10-41 and the Checklist appear to go well beyond the expectations of the SEC and the MSRB as described above.

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17 *Id*.

18 For a recent indication of market professional concern about the reliability of internet information on municipal bonds, see Christine Albano, Data Overload for Retail Investors, The Bond Buyer, May 10, 2011.

19 "[T]he Commission agrees with those commenters that said that additional information ***made available by issuers*** will be taken into account by dealers making recommendations regarding that security, under the MSRB's fair dealing and suitability rules, and the antifraud provisions. [See, e.g., Letter of MSRB (emphasizing that, in the Board's view, dealers would be responsible for continuing disclosure information available in NRMSIRs even without the specific "review" requirement); Letter of Paine Webber.] In addition to the Commission's past interpretations of the responsibilities of dealers to have a reasonable basis for their recommendations, the MSRB repeatedly has emphasized that secondary market disclosure information ***publicized by issuers*** must be taken into account by dealers to meet the investor protection standards imposed by its investor protection rules" (*emphasis added)*. Release No. 34-34961.

Does FINRA expect dealers to investigate all the statements made in press releases, news articles, and blog posts? When tied to non-recommended as well as recommended transactions, the combination of potential issues of municipal securities by the 60,000 or more municipal issuers covered, as estimated by the MSRB, and reflected by the more than 1.2 million municipal market CUSIPs together with such a search expectation produces a compliance task that is without exaggeration Sisyphean in its nature. This would create such a burden on dealers that it would almost certainly cause them to refuse to effect transactions in unfamiliar securities—likely to be those issued by smaller or less frequent issuers—and would have the effect of reducing liquidity in the markets.

## IV. OTC Equity Securities in Contrast

Transactions in municipal securities carry a greater regulatory burden for dealers than transactions in other securities. For example, FINRA Rule 2114[20], applicable to OTC Equity Securities, offers a useful contrast to FINRA 10-41 and the Checklist as well as MSRB interpretation of G-17. For example, Rule 2114:

- is limited in application to recommended transactions;
- looks to "current financial statements" defined to include balance sheets, publicly available financial information, and "current material business information" defined to include "information that is ascertainable through the reasonable exercise of professional diligence and that a reasonable person would take into account in reaching an investment decision;"
- contains specific compliance requirements, with the required review conducted periodically by an identified registered person; and
- provides exemptions, including for transactions with accounts that qualify as an "institutional account" under NASD Rule 3110(c)(4), or with a customer that is a "qualified institutional buyer" under Securities Act Rule 144A or "qualified purchaser" under Section 2(a)(51) of the Investment Company Act.

[20] FINRA Rule 2114(a) provides: No member or person associated with a member shall recommend that a customer purchase or sell short any OTC Equity Security, unless the member has reviewed the current financial statements of the issuer, current material business information about the issuer, and made a determination that such information, and any other information available, provides a reasonable basis under the circumstances for making the recommendation.

By comparison, the Checklist and FINRA 10-41:

- apply when a Dealer is only acting as an order taker and did not recommend the security as well as to recommended transactions;[21]

- include, by way of the Checklist, expectations of use of "search engines" and "local newspapers" to gather information from independent sources other than the issuer, in addition to MSRB defined "established industry sources;"

- require transaction by transaction review and recordkeeping by individual brokers, not periodic review by an identified registered person; and

- provide an exemption to affirmative disclosure obligations for sophisticated municipal market professionals ("SMMPs"), a category of investor not directly comparable to those exempted under Rule 2114.

Unlike FINRA Rule 2114 and Rule 15c2-12, FINRA 10-41 and the Checklist apply to unsolicited transactions. The MSRB likewise interprets G-17, G-19, and G-30 as applying to both recommended trades and when a Dealer is acting only as an order taker.[22] Dealers already face a substantially greater compliance burden compared to the OTC equities market simply because of the extension to unsolicited trades. FINRA's expansion to cover internet based information produced by independent sources moves an already difficult situation to a point at which the willingness by Dealers to trade certain municipal securities may evaporate, with a resulting adverse affect to both investors and issuers.

We are mindful that the Board has from its earliest rulemaking underscored the notion that "the customs and practices of the municipal markets … may … in many instances differ from that in the corporate securities markets."[23] While such differences may perhaps remain, even after several years of operation of EMMA, the differences highlighted by comparison to FINRA 2114 do illustrate the disproportionate burdens borne by Dealers. The successful implementation of EMMA as a broad and readily accessible source of disclosure information to the municipal marketplace as well as its continuing expansion to embrace new forms of disclosure information has already dramatically altered the availability of disclosure to the market. It may soon be time to revisit some of the initial assumptions regarding disclosure underlying MSRB rulemaking and the corresponding burdens placed upon municipal dealers, for these assumptions may no longer coincide with realities in the modern municipal securities market.

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21 Interpretive Notice Regarding Rule G-17, On Disclosure of Material Facts (March 20, 2002).

22 MSRB Notice 2009-42.

23 Exchange Act Release No. 14519 (March 2, 1978).

## V. 1994 Amendments to Rule 15c2-12 and Concern for Market Liquidity

The volume and quality of dialogue between regulator and all segments of the municipal market produced meaningful and productive results in the Commission's 1994 effort to create a framework for municipal market continuing disclosure, including with respect to balancing the burdens placed on Dealers and the vitality of the municipal market. The 1994 amendments to Rule 15c2-12 incorporate a critical determination by the Commission in Dealer regulation. Specifically, the Commission initially proposed to require Dealer trade-by-trade review of the continuing disclosure required under the Rule amendments and prohibition of recommendation of any securities for which the information was not available. After "the Group of 12," a group representing issuers, trustees, bond lawyers, buy-side analysts, underwriters, and municipal securities dealers warned that the Commission's proposal "could freeze trading in the secondary market for certain outstanding bonds" and "would harm investors by reducing liquidity, and therefore market price, and is not only a concern for broker-dealers because of the compliance burdens, but for issuers who desire more competitive and efficient markets for their securities and increased access to the market at better prices,"[24] the Commission reversed course and rejected "mechanical review requirements on a trade- by-trade basis" under its proposed formulation of Rule15c2-12(c). Instead, the current requirement that the municipal securities dealer have "procedures in place that provide reasonable assurance that it will receive prompt notice of any event" disclosed pursuant to the Rule was put in place.[25]

It is important to note that the abandoned requirement would have applied only to transactions recommended by dealers and yet was considered to be too burdensome for dealers in even that limited subset of secondary market transactions. As noted above, the Commission understood that, even without a specific review requirement, the information made available to NRMSIRs (today EMMA) would be reviewed by Dealers under the MSRB's fair dealing and customer protection rules.[26] As the Commission told Congress at the time, "The MSRB has interpreted [G-17] to mean among other things, that a dealer must disclose to a customer, at or before the time of sale, all material facts concerning the transaction, including a complete description of the security, and must not

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[24] Joint Response to the Securities and Exchange Commission on Releases Concerning Municipal Securities Market Disclosure, attached to August 11, 1994 letter of Government Finance Officers Association to Jonathan G. Katz, Secretary, Securities and Exchange Commission.

[25] Release No. 34-34961.

[26] Note 12, supra.

omit any material fact that would render any other statement misleading."[27] The Commission further explained: "the MSRB has reminded dealers of their duty of full disclosure under [G-17], and periodically has pointed out specific items that should be disclosed to the customer."[28]

Subsequent MSRB interpretation of G-17 beginning with the 2002 introduction of the affirmative duty to consult reasonably available information about a security from established industry sources, and expansion of the detailed information to be disclosed in 2008 and 2009,[29] has moved the regulatory burden on Dealers far beyond the point described by the Commission in 1994. FINRA 10-41 and the Checklist, by application to each trade, whether or not recommended, bring the regulatory burden on Dealers full circle and even beyond the point initially proposed and the rejected by the Commission in the 1994 amendments. The Commission's initial proposal caused great alarm among issuers and investors, as well as dealers at the time in view of its potential to damage market liquidity. We have arrived at the same point today in a round-about way. Concerns regarding liquidity then exist today as well.

## VI. Request and Closing

We are concerned that the actions of FINRA with respect to FINRA 10-41 and the Checklist and of the Board's interpretive rulemakings under G-17 have pushed Dealer regulatory burdens beyond the balance point determined by the Commission in 1994 and may begin to yield the damage to market liquidity the Commission sought to avoid.

We request that FINRA give strong consideration to issuance of the attached FAQs and we welcome an opportunity for a small group of no more than five to seven of us to discuss them with you and your staff at your earliest convenience.

As this letter makes clear, we have additional concerns that fall more appropriately within the rulemaking authority of the MSRB, and are providing it as well as the SEC with a copy of this letter.

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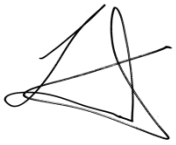
27 Staff Report on the Municipal Securities Market (September 1993), available at: http://www.sec.gov/info/municipal/mr-munimarketreport1993.pdf.

28 Id, n. 52.

29 MSRB Notice 2008-04 (January 22, 2008), MSRB Notice 2009-42 (July 14, 2009).

Thank you for your consideration of our request, and please do not hesitate to contact me on this matter by phone at (212) 313-1130 or via email at lnorwood@sifma.org.

Sincerely yours,



Leslie M. Norwood
Managing Director and
Associate General Counsel

cc: ***Securities and Exchange Commission***
The Honorable Mary L. Schapiro, Chairman
Robert Cook, Director, Division of Trading and Markets

***Financial Industry Regulatory Authority***
Malcolm P. Northam, Director Fixed Income Securities

***Municipal Securities Rulemaking Board***
Lynnette Kelly Hotchkiss, Executive Director

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**Frequently Asked Questions about FINRA 10-41**

## A. *Foundational Questions Regarding FINRA 10-41*

1. What is the respective authority of the regulators regarding rules relating to the conduct of brokers, dealers and municipal securities dealers ("municipal dealers") engaging in municipal securities transactions?

*Answer:* FINRA has the authority to carry out inspections and bring enforcement actions relating to the conduct of municipal dealers engaging in municipal securities transactions; however, sole authority to adopt or interpret rules relating to municipal dealers resides with the Municipal Securities Rulemaking Board ("MSRB") and Securities and Exchange Commission ("SEC" or "Commission").

2. What regulations apply to disclosure obligations of municipal dealers to their customers in connection with secondary market municipal securities transactions?

*Answer:* (a) The antifraud provisions of federal securities laws, namely Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, and Section 15(c)(2) of the Exchange Act, each prohibiting fraudulent, deceptive, or manipulative act or practices, and in the case of Securities Act Section 17(a) and Exchange Act Rule 10b-5 expressly prohibiting the use of materially misleading misstatements or omissions in connection with a securities transaction; and (b) MSRB Rules G- 15, relating to information required in customer confirmations, and G-17, requiring fair dealing and prohibiting deceptive, dishonest, or unfair practices, both adopted by the MSRB under Exchange Act Section 15B(b)(2).

In addition, SEC Rule 15c2-12(c) and MSRB Rules G-19 and G-30, while not directly regulating the disclosure to a customer in connection with a secondary market municipal securities transaction, provide certain foundational requirements to such transactions. Specifically,

- Rule 15c2-12(c) prohibits recommendations of secondary market municipal securities transactions, unless a municipal dealer has procedures

in place that provide reasonable assurance that it will receive prompt notice of any event disclosed pursuant to continuing disclosure agreements required by the Rule;

- Rule G-19 requires a municipal dealer to (a) make reasonable efforts to obtain certain information about the financial circumstances and investment objectives of a customer, prior to making a recommendation of a municipal securities transaction to a non-institutional account[30], and (b) 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); and

- Rule G-30 requires municipal dealers to take a certain set of factors into account when purchasing or selling municipal securities as principal and a certain set of factors into account when purchasing or selling a municipal security as agent.

3. What are municipal dealers required to disclose to their customers in secondary market municipal securities transactions under Rule G-17?

*Answer:* The MSRB has interpreted Rule G-17 to require municipal dealers in secondary market municipal securities transactions to disclose to their customers "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. Information available from established industry sources is deemed to be reasonably accessible to the market for purposes of this Rule G-17 disclosure obligation."[31]

4. What does "established industry sources" mean?

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[30] The term "institutional account" for the purposes of this section shall have the same meaning as in rule G-8(a)(xi). Rule G-8(a)(xi) provides: "For purposes of this subparagraph, the term "institutional account" shall mean 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."

[31] Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities, MSRB Notice 2009-42 (July 14, 2009); *See also* Rule G-17 Interpretation – Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002 (2002 Interpretive Notice), MSRB Reminds Firms of Their Sales Practice and Due Diligence Obligations When Selling Municipal Securities in the Secondary Market, MSRB Notice 2010-37 (Sept. 20, 2010) 2010 Reminder Notice.

*Answer:* The MSRB defined "established industry sources" in a 2002 Interpretive Release as follows: "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").[32]

5. Does the MSRB interpretation of a municipal dealer's affirmative disclosure obligation under Rule G-17 change with respect to a customer who is a Sophisticated Municipal Market Professional ("SMMP")?

*Answer:* Yes, the MSRB has stated: "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" and that "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."[33]

6. Do any of the above statutes and rules require municipal dealers to establish and maintain specific procedures relating to disclosures to customers in secondary market municipal security transactions?

*Answer:* SEC Rule 15c2-12 and MSRB Rule G-27 require municipal dealers to have general procedures in place, but neither the SEC nor the MSRB has promulgated specific procedures relating to disclosures to customers in secondary market municipal securities transactions. The general procedural requirements under Rule 15c2-12 and MSRB Rule G-27 are:

- SEC Rule 15c2-12(c) requires municipal dealers to have procedures in place that provide reasonable assurance that it will receive prompt notice of any event disclosed pursuant to continuing disclosure agreements required by the Rule before recommending a municipal security to a customer. The SEC has not provided any interpretation or guidance to this requirement since its adoption in 1994.

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[32] 2002 Interpretive Notice.

[33] Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals, April 30, 2002.

- MSRB Rule G-27 requires firms to supervise their municipal securities business, and to ensure that they have adequate policies and procedures in place for monitoring the effectiveness of their supervisory systems. In a recent interpretive notice, the MSRB stated: "Rule G-27 requires that a firm's supervisory procedures provide for the regular and frequent review and approval by a designated principal of customer accounts introduced or carried by the dealer in which transactions in municipal securities are effected, with such review being designed to ensure that transactions are in accordance with all applicable rules and to detect and prevent irregularities and abuses."[34]

- In the same interpretive notice, the MSRB encouraged but did not require establishing procedures relating to customer disclosures: "Although ***the rule does not establish a specific procedure for ensuring compliance*** with the requirement to provide disclosures to customers pursuant to Rule G-17, ***firms should consider including in their procedures*** for reviewing accounts and transactions specific processes for documenting or otherwise ascertaining that such disclosures have been made. (emphasis added)" [35]

7. Has the MSRB promulgated procedural requirements relating to established industry sources?

*Answer:* No, the MSRB has not adopted any rule relating expressly to access to or use of established industry sources.

However, it has stated in an interpretive release that "firms should review their policies and procedures for obtaining material information about the bonds they sell to make sure they are reasonably designed to access all material information that is available, whether through EMMA or other established industry sources."[36]

In the same release, the MSRB stated: "The scope of material information that dealers are obligated to disclose to their customers under Rule G-17 is not limited solely to the information made available through established industry sources. Dealers also must disclose material information they know about the securities even if such information is not then available from established industry sources. It is essential that dealers establish procedures reasonably designed to ensure that information known to the dealer is communicated internally or otherwise made available to relevant personnel in a manner reasonably designed to ensure compliance with this disclosure obligation."[37]

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34 (2010 Reminder Notice).
35 Id.
36 MSRB Notice 2009-42.
37 Id.

8. Must the gathering of material facts from established industry sources and those known to a municipal dealer be performed by each individual broker or sales representative?

*Answer:* The most recent MSRB guidance clearly speaks of these obligations in terms of the municipal dealer, not an individual municipal securities representative: "Dealers must also obtain, analyze and disclose all material facts about secondary market transactions that are known to the dealer, or that are reasonably accessible to the market through established industry sources."[38]

9. Do MSRB rules require municipal dealers to review "Bloomberg, search engines, or local newspapers" for potentially material information before a secondary market municipal transaction with a customer?

*Answer:* The MSRB has never interpreted its rules to require a municipal dealer review "Bloomberg, search engines, or local newspapers" for potentially material information before a secondary market municipal transaction with a customer.

The MSRB has recently stated "In meeting these disclosure, suitability and pricing obligations [under Rules G-17, G-19 and G-30], firms must take into account all material information that is known to the firm or that is available through "established industry sources," including official statements, continuing disclosures, and trade data, much of which is now available through EMMA. Resources outside of EMMA ***may*** include press releases, research reports and other data provided by independent sources." (emphasis added).[39] The MSRB has provided no indication in the interpretive notice of what circumstances, if any, in which a municipal dealer would be ***required to*** consult press releases, research reports and other data provided by independent sources.

## B. *Questions about FINRA 10-41*

1. Is use of the checklist appended to FINRA 10-41 mandatory?

*Answer:* The checklist is voluntary and intended to provide an expansive illustration of the various considerations that may apply in a conversation with customers considering a municipal securities transaction.

[38] 2010 Reminder Notice.
[39] 2010 Reminder Notice.

2. Does the failure of a municipal dealer to maintain a written record of disclosures made to a customer in a secondary market municipal securities transaction constitute a violation of SEC or MSRB rules?

*Answer:* Neither SEC nor MSRB rules require a municipal dealer to maintain a written record of disclosures made to a customer in a secondary market municipal securities transaction, so neither SEC nor MSRB rules will be violated if a municipal dealer does not maintain such written records.

3. Does a failure of a municipal dealer to review Bloomberg, search engines, or local newspapers before entering into a secondary market municipal securities transaction with a customer constitute a violation of SEC or MSRB rules?

*Answer:* Neither SEC nor MSRB rules require a municipal dealer to review Bloomberg, search engines, or local newspapers before entering into a secondary market municipal securities transaction.

4. May individual municipal securities representatives look to centralized procedures maintained by their firm to gather material information from established industry sources as well as material information known to the municipal dealer?

*Answer:* Yes. Both SEC and MSRB rules speak to the dealer establishing such procedures and communicating the information internally.

5. Does FINRA 10-41 create a transaction-by-transaction requirement to conduct searches of established industry sources and material information about a security known to the municipal dealer?

*Answer:* FINRA 10-41 is intended to remind municipal dealers of requirements under existing MSRB rules and interpretations, not to create new requirements. The most recent MSRB guidance clearly speaks of these obligations in terms of the municipal dealer, not an individual municipal securities representative: "Dealers must also obtain, analyze and disclose all material facts about secondary market transactions that are known to the dealer, or that are reasonably accessible to the market through established industry sources."[40]

6. Does FINRA 10-41 apply to non-recommended electronic trades by non-SMMP customers?

[40] Id.

*Answer:* FINRA 10-41 does not address non-recommended electronic trades by non-SMMP customers. However, in the 2002 interpretive notice first defining the term "established industry sources," the MSRB stated:

> Dealers 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. *See* Rule G-17 Interpretation – Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, *reprinted in* MSRB Rule Book (the "2002 Disclosure Notice").

As a result, municipal dealer provision of access to EMMA on an electronic platform would appear generally to satisfy municipal dealer disclosure obligations under G-17. Since FINRA 10-41 is intended to remind municipal dealers of those requirements, such access would also be consistent with FINRA 10-41.