

2018-07

Publication Date
April 12, 2018

Stakeholders
Municipal Securities
Dealers

Notice Type
Regulatory Reminder

Category
Fair Practice

Affected Rules
[Rule G-47](#), [Rule G-19](#),
[Rule G-30](#), [Rule G-15](#)

Notice Regarding Transactions in the Municipal Securities of Distressed Municipalities

Overview

Transactions in the municipal securities of distressed municipalities recently have received increased attention in the municipal securities market, in some instances based on substantial price fluctuations. The MSRB is publishing this notice to remind brokers, dealers and municipal securities dealers (collectively, “dealers”) of some of the investor protection rules applicable to dealers effecting customer transactions in such securities.

Summary of Select Investor Protection Rules

Time of Trade Disclosures to Customers. MSRB Rule G-47 requires dealers to disclose to their customers, 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. This disclosure obligation applies whether the transaction is unsolicited or recommended, and whether it is a primary offering or secondary market transaction. Information is considered to be material under Rule G-47 if there is a substantial likelihood that the information would be considered important or significant by a reasonable investor in making an investment decision, including facts material to an assessment of the potential risks of the security.

Rule G-47 includes, in Supplementary Material .03, a list of examples describing information that may be material in specific scenarios, and therefore require time-of-trade disclosures to a customer. The list of examples, which is not exhaustive, includes:

- *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.



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- *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.
- *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.¹
- *Failure to make continuing disclosure filings.* Discovery that an issuer has failed to make filings required under its continuing disclosure agreements.

Suitability. Rule G-19 requires dealers to have a reasonable basis to believe that a recommended transaction or investment strategy involving a municipal security is suitable for the customer, based on information obtained through the reasonable diligence of the dealer to ascertain the customer's investment profile. For example, this requires a dealer to consider the nature of the security as well as the customer's financial situation and needs, tax status, risk tolerance and investment objectives when making recommendations to customers. The dealer must have reasonable grounds for believing that the recommendation is suitable, based upon information available about the security and the facts disclosed by or otherwise known about the customer.

Fair Pricing. Rule G-30 requires that, for principal transactions with customers, a dealer may only purchase securities from, or sell securities to, a customer at an aggregate price (including any mark-up or mark-down) that is fair and reasonable. Supplementary Material .02 describes relevant factors in determining the fairness and reasonableness of prices, including but not limited to:

- Whether the yield is comparable to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market;

¹ Rule G-15(f) generally prohibits dealers from effecting a customer transaction in an amount lower than the minimum denomination of the issue, subject to limited exceptions.

- The best judgment of the dealer concerning the fair market value of the securities; and
- The existence of material information about a security available through the MSRB's Electronic Municipal Market Access (EMMA[®]) website or other established industry sources.

Discussion

Dealers should be mindful of all applicable rules when effecting customer transactions in the municipal securities of a distressed municipality, including those investor protection rules summarized above.² For example, dealers should ensure that they are providing the necessary time-of-trade disclosures, including to the extent applicable, those regarding the credit risk of a security, discovery that an issuer has failed to make filings required under its continuing disclosure agreements, and/or the fact that a sale of a quantity of municipal securities is below the minimum denomination authorized by the bond documents. In the case of the latter, dealers should also ensure that the purchase or sale of the securities falls within one of the exceptions to Rule G-15(f). Dealers are also reminded that the obligation to make the appropriate time-of-trade disclosures applies regardless of whether the transaction was solicited or unsolicited. Dealers also should be conscious of their suitability obligations and are reminded that, depending on a customer's investment profile, it may not be suitable to recommend the purchase of the municipal securities of a distressed municipality in light of the potential risks of the investment. Finally, when pricing securities, dealers should specifically consider, among other factors, the effect of material information about the securities available through established industry sources on the fairness and reasonableness of the price.

Dealers also are reminded of the resources in the MSRB Education Center to assist customers with understanding how to use the [EMMA website](#) to actively [monitor an issuer's financial health and the secondary market trading of municipal bonds](#).

Questions about this notice should be directed to Michael L. Post, General Counsel, or Saliha Olgun, Associate General Counsel, at 202-838-1500.

April 12, 2018

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² If a customer is a specifically defined "sophisticated municipal market professional" or SMMP, dealers may be relieved of some, but not all of the obligations summarized in this notice under Rule G-48, on transactions with sophisticated municipal market professionals.