

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

Form 19b-4 Information (required)

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

Exhibit 1 - Notice of Proposed Rule Change (required)

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

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

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Exhibit Sent As Paper Document

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

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

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

Exhibit 4 - Marked Copies

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

Exhibit 5 - Proposed Rule Text

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

Partial Amendment

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

1. Text of Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² the Municipal Securities Rulemaking Board (the “MSRB” or “Board”) is filing with the Securities and Exchange Commission (the “SEC” or “Commission”) a proposed rule change consisting of a restatement of an interpretive notice (the “Existing SMMP Notice” and the “Restated SMMP Notice,” respectively) concerning the application of MSRB Rule G-17 (on conduct of municipal securities and municipal advisory activities) to sophisticated municipal market professionals (“SMMPs”). Because of the relationship between the proposed rule change and FINRA Rule 2111 (on suitability), the MSRB requests that the proposed rule change be made effective on July 9, 2012, which is the date on which FINRA Rule 2111 will become effective.

(a) The text of the proposed rule change is attached as Exhibit 5. Material proposed to be added is underlined. Material proposed to be deleted is enclosed in brackets.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the MSRB on January 25-27, 2012 and March 14-16, 2012. Questions concerning this filing may be directed to Peg Henry, General Counsel, Market Regulation at 703-797-6600.

3. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

EXISTING DEFINITION OF SMMP

Under the Existing SMMP Notice, a dealer is permitted to treat an institutional customer³ as an SMMP if the dealer has reasonable grounds for concluding the following and other known facts do not contradict such a conclusion:

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ For purposes of the Existing SMMP Notice, an institutional customer is defined as “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.”

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

Although the Existing SMMP Notice permits a dealer to have an investor attest to SMMP status “as a means of streamlining the dealers’ process for determining that the customer is an SMMP,” it also provides that a dealer may not rely on such an attestation if the dealer knows or has reason to know that the investor lacks sophistication concerning a municipal securities transaction based on a number of factors set forth in the notice.

Access to Material Facts. As to the first part of the definition of SMMP, access to material facts, the Existing SMMP Notice provides that a dealer’s analysis may depend on the customer’s resources to investigate the transaction (*e.g.*, research analysts) and the customer’s ready access to established industry sources for disseminating material information concerning the transaction (*e.g.*, the predecessors of the MSRB’s Electronic Municipal Market Access (“EMMA”) System and the MSRB’s Real-Time Trade Reporting System (“RTRS”), rating agency data, and other indicative data sources).

Independent Evaluation of Investment Risk and Market Value. As to the second part of the definition of SMMP, independent evaluation of risk and market value, the Existing SMMP Notice identifies the following relevant factors:

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

Independent Investment Decisions. As to the third part of the definition, independent investment decisions, the Existing SMMP Notice provides that such a

determination will depend on the nature of the relationship between the dealer and the institutional customer and provides that the following considerations may be relevant:

- 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.

APPLICATION OF EXISTING SMMP DEFINITION

The Existing SMMP Notice addresses a dealer's obligations to an SMMP under Rule G-17 (on fair dealing), Rule G-18 (on execution of transactions), Rule G-19 (on suitability), and Rule G-13 (on quotations).

Rule G-17. Just prior to the adoption of the Existing SMMP Notice, the SEC approved another MSRB notice⁴ in which the MSRB interpreted Rule G-17 to require brokers, dealers, and municipal securities dealers ("dealers") to disclose to customers at or before the time of trade all material facts about a transaction known by the dealer, as well as all material facts about a security reasonably accessible to the market from established industry sources.⁵ The Existing SMMP Notice provides that, when a dealer effects a non-recommended secondary market transaction with an SMMP, its affirmative Rule G-17 disclosure duty concerning material facts available from established industry sources will be deemed satisfied. The Existing SMMP Notice does not alter a dealer's

⁴ MSRB Interpretive Notice Regarding Rule G-17, On Disclosure of Material Facts (March 20, 2002) (the "2002 Rule G-17 Notice").

⁵ The 2002 Rule G-17 Notice was updated in 2009 to reflect, among other things, the addition of EMMA as an established industry source. *See* MSRB Guidance On Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities (July 14, 2009). The 2009 Notice also extended the Rule G-17 affirmative disclosure obligation to "material information."

duty not to engage in deceptive, dishonest, or unfair practices under Rule G-17 or under the federal securities laws. In essence, it puts the dealer's disclosure obligations to SMMPs when effecting non-recommended secondary market transactions on a par with inter-dealer disclosure obligations. The Existing SMMP Notice provides that, 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.

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 Existing SMMP Notice provides that a dealer effecting a non-recommended secondary market agency transaction to an SMMP is not required to take further actions to ensure that the transaction is effected at a fair and reasonable price, if 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 Existing SMMP Notice then states that this interpretation of Rule G-18 is particularly relevant to dealers operating alternative trading systems, stating that dealers operating such systems may be merely aggregating the buy and sell interest of other dealers or SMMPs. A footnote to the Existing SMMP Notice says that the same interpretation would apply to a broker's broker when executing an agency transaction for another dealer.

Rule G-19. Under Rule G-19, in the case of a recommended transaction, a dealer must have a reasonable basis for recommending a particular security ("reasonable-basis suitability"), as well as reasonable grounds for believing the recommendation is suitable for the customer to whom it is made, 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 ("customer-specific suitability"). The Existing SMMP Notice provides that, when a dealer has reasonable grounds for concluding that an institutional customer is an SMMP, the dealer's customer-specific suitability obligation is fulfilled.

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. 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.

The Existing SMMP Notice provides that, if a dealer disseminates the quotation of an SMMP and it is labeled as such, the disseminating dealer will be held to the same standard as if it were disseminating a quotation made by another dealer. The notice says that the following factors are relevant to the dealer's assessment of whether dissemination of the SMMP's quotation may be considered to be a violation of Rule G-13 by the dealer: (i) complaints received from dealers and investors seeking to execute against such quotations, (ii) a pattern of an 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 an SMMP effecting transactions at prices that depart materially from the prices listed in the quotations in a manner that consistently is favorable to the SMMP making the quotation.

CONSIDERATIONS FOR CHANGE

Increased Availability of Information about Municipal Securities. In 2002, the MSRB decided to adopt a definition of SMMP that differed from certain other regulatory definitions of investors considered sophisticated enough to receive special treatment under the federal securities law. The SMMP definition was closely modeled on an NASD interpretation of its suitability rule,⁶ which contained a comparable list of factors found relevant to an investor's independent evaluation of risk and independent investment decisions. A notable difference was that the definition of SMMP also looked to whether the investor had access to material facts. A key factor in the MSRB's decision was the lack of information available about municipal securities at that time. Since the adoption of the existing definition of SMMP, there has been a vast increase in the availability of information about municipal securities reasonably accessible by institutional investors regardless of the amount of their holdings of municipal securities (*e.g.*, on EMMA, from rating agencies, and from other information vendors).

New FINRA Institutional Suitability Rule. Effective July 9, 2012, the NASD guidance on institutional suitability will no longer be in effect. It will be replaced by FINRA Rule 2111, which adopts a different approach to a FINRA member's customer-specific duty of suitability to an "institutional account."⁷ Under FINRA Rule 2111, a

⁶ See IM-2310-3. Suitability Obligations to Institutional Customers.

⁷ The term "institutional account" will be defined in the same manner as under MSRB Rule G-8(a)(xi). MSRB 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

dealer's customer-specific suitability obligation to an institutional customer will be considered satisfied if (1) the dealer has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the dealer's recommendations. There will no longer be a detailed listing of factors, such as that found in the Existing SMMP Notice. The MSRB generally considers it desirable from the standpoint of reducing the cost of dealer compliance to maintain consistency with FINRA rules, absent clear reasons for treating transactions in municipal securities differently.

PROPOSAL TO RESTATE SMMP NOTICE

Revised Definition of SMMP. Because the quality and availability of information concerning municipal securities has improved substantially since 2002, and to maintain consistency with the revised FINRA suitability rule for institutional customers, the MSRB proposes to retain the concept of an SMMP, but revise its definition so that it is consistent with the new FINRA suitability rule for institutional customers. Specifically, the MSRB proposes that an "SMMP" be defined as an "institutional customer⁸ 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."

The MSRB also proposes to include the following statement in the Restated SMMP Notice's discussion of the definition of SMMP: "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."

The key to the revised definition of SMMP is the requirement that a dealer have a reasonable basis to believe that an investor is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions in municipal securities (sometimes referred to in this filing as the "reasonable basis analysis"). When the MSRB created the existing definition of SMMP, alternative trading systems for municipal securities were new and access to material facts about municipal

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.

⁸ "Institutional customer" would be defined as a customer with an institutional account (as defined under MSRB Rule G-8(a)(xi)).

securities was in large part limited to very large institutional investors. The high threshold for determining whether an investor would be considered an institutional customer under the Existing SMMP Notice (\$100 million of municipal securities owned and/or under management) was considered necessary to make sure that only the most sophisticated institutions and dealers were likely to use alternative trading systems. The Restated SMMP Notice would provide that, as part of its reasonable basis analysis, a dealer should consider the amount and type of municipal securities owned or under management by the institutional customer. However, there would no longer be a threshold requirement that a customer own or manage a certain amount of municipal securities in order to be considered an SMMP.

The MSRB also proposes that, in the case of the affirmation described in clause (2) of the revised definition of SMMP (*i.e.*, “capable of evaluating investment risks and market value independently”), customers be allowed to make the affirmation orally or in writing and to provide the affirmation on a trade-by-trade basis, on a type-of-municipal-security basis (*e.g.*, general obligation, revenue, VRDO, etc.), or for all potential transactions for the customer’s account. This would be consistent with the affirmation requirement of FINRA Rule 2111, so receipt by a dealer of the FINRA 2111 affirmation would also satisfy this requirement.

Application of Revised SMMP Definition. The Restated SMMP Notice would not change the application of Rules G-18, G-19, and G-13 to SMMPs. However, it would change the application of Rule G-17 to SMMPs, under the assumption that institutional customers now have substantial access to material information about municipal securities. The Existing SMMP Notice limits the exclusion from the duty to disclose all material facts to SMMPs to non-recommended transactions. The Restated SMMP Notice would apply the exclusion to all transactions with SMMPs, whether recommended or self-directed. The Restated SMMP Notice would also remove the lists of factors that were deemed by the Board in 2002 to be relevant to the components of the original definition of SMMP. It would also update the Existing SMMP Notice to reflect developments in the MSRB’s interpretations of Rule G-17 since 2002 and remove endnote 9 to the Existing SMMP Notice, which has been construed by some to lessen the duty of a broker’s broker under Rule G-18 in a manner that is inconsistent with the Board’s proposed Rule G-43 (on broker’s brokers).⁹ Furthermore, it would remove the language that suggests that transactions on alternative trading systems are done on an agency basis, because at least one major alternative trading system engages only in principal transactions.

(b) The MSRB believes that the proposed rule change is consistent with Section 15B(b)(2) of the Securities Exchange Act (“Exchange Act”), which provides that:

⁹ File No. SR-MSRB-2012-04 (March 5, 2012). The MSRB notes that, under proposed Rule G-43(d)(iii)(A), an alternative trading system that had any customers (as defined in MSRB Rule D-9) that were not SMMPs would not be excepted from the definition of “broker’s broker.”

The Board shall propose and adopt rules to effect the purposes of this title with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers and advice provided to or on behalf of municipal entities or obligated persons by brokers, dealers, municipal securities dealers, and municipal advisors with respect to municipal financial products, the issuance of municipal securities, and solicitations of municipal entities or obligated persons undertaken by brokers, dealers, municipal securities dealers, and municipal advisors.

Section 15B(b)(2)(C) of the Exchange Act, provides that the rules of the MSRB shall:

be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest.

The proposed rule change is consistent with Sections 15B(b)(2) and 15B(b)(2)(C) of the Exchange Act. Its principal purpose is to remove impediments to and perfect the mechanism of a free and open market in municipal securities, particularly in the case of the alternative trading systems that have been an increasingly important venue for the provision of secondary market liquidity for municipal securities. New municipal securities products, such as Build America Bonds, and decreasing spreads between interest rates on Treasury bonds and municipal securities, have attracted investors that were not previously invested in municipal securities to the municipal securities market. At the same time, the amount of available information about municipal securities has vastly increased since the Existing SMMP Notice was approved. While the Restated SMMP Notice would provide that a dealer should consider the amount and type of municipal securities owned or under management by the institutional customer, the MSRB no longer considers it essential that an institutional customer own or manage municipal securities in order to engage in informed decisionmaking about municipal securities investments. The MSRB believes it is appropriate to allow sophisticated investors to trade in municipal securities on alternative trading systems even though they do not meet the \$100 million threshold of municipal securities owned and/or managed found in the Existing SMMP Notice. This change would not come at the expense of investor protection. While the application of the proposed rule change would not be limited to transactions on alternative trading systems, the application of certain MSRB rules to such systems has proven difficult in practice, especially with the increasing use of computerized algorithmic trading. The MSRB notes that such systems, if monitored

closely and subjected to appropriate rulemaking,¹⁰ have the potential to increase pre-trade transparency in the municipal marketplace, which should eventually improve prices for all investors. The MSRB also generally considers it desirable from the standpoint of reducing the cost of dealer compliance to maintain consistency with FINRA rules, absent clear reasons for treating transactions in municipal securities differently.

4. Self-Regulatory Organization’s Statement on Burden on Competition

The MSRB does not believe that the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, since it would apply equally to all dealers that have SMMP customers, whether alternative trading systems or not.

5. Self-Regulatory Organization’s Statement on Comments Received on the Proposed Rule Change by Members, Participants, or Others.

On November 8, 2011, the MSRB requested comment on the original version of the proposed rule change.¹¹ The MSRB received comment letters from (1) Alternative Regulatory Solutions, LLC (“ARS”); (2) Bond Dealers of America (“BDA”); (3) Securities Industry and Financial Markets Association (“SIFMA”); and (4) TMC Bonds L.L.C. (“TMC”), formerly The MuniCenter.¹²

Safe Harbor. The original version of the Restated SMMP Notice on which comment was requested proposed a safe harbor for satisfaction of the dealer’s reasonable basis analysis. Most of the comments concerned that safe harbor. The reasonable basis analysis portion of the definition of SMMP is referred to in this discussion of comments as the “general rule.” SIFMA said that the safe harbor was too restrictive. It requested that: (1) the types of assets owned or under management required by the safe harbor not be limited to municipal securities, and (2) the attestation requirement of the safe harbor¹³ either be eliminated entirely or eliminated for certain types of institutional customers (*i.e.*, banks, savings and loan associations, insurance companies, registered investment companies, and federally- or state-registered investment advisers). SIFMA said that, if the assets required for the safe harbor were required to be municipal securities, the dollar threshold should be reduced from \$50 million to \$25 million of municipal securities owned or under management. TMC said that the safe harbor should require ownership and/or management of at least \$50 million of direct fixed income securities. BDA

¹⁰ The MSRB notes that proposed MSRB Rule G-43 would provide for additional regulation of such alternative trading systems.

¹¹ See MSRB Notice 2011-63 (November 8, 2011).

¹² See Exhibit 2.

¹³ Both the general rule and the safe harbor contained “attestation” requirements, unlike the version of the SMMP definition in the proposed rule change.

advocated that an institutional investor with at least \$25 million of fixed income securities should qualify for the safe harbor without the need for an attestation. ARS recommended that the attestations of the general rule and the safe harbor be combined and that all attestations be required to be in writing. ARS also recommended that the safe harbor requirement of \$50 million of municipal securities be determined on an average annual basis and asked how often a dealer would be required to verify this asset concentration.

The MSRB has determined to eliminate the safe harbor from the proposed rule due to a concern that the amount of municipal securities owned or managed by a customer does not necessarily equate to sophistication. Nevertheless, the Restated SMMP Notice would provide that, as part of its reasonable basis analysis, a dealer should consider the amount and type of municipal securities owned or under management by an institutional customer.

As to ARS's comment concerning the frequency with which the \$50 million threshold of the safe harbor would need to be measured, while the safe harbor has been eliminated, the question is still relevant to the frequency with which dealers would need to take steps to reassess their reasonable basis determinations with respect to their institutional customers. Dealers should monitor their reasonable basis determinations as frequently as they consider prudent, just as they would need to do so if they planned to treat natural persons with total assets of at least \$50 million as institutional customers under either FINRA Rule 2111 or the Restated SMMP Notice.¹⁴

¹⁴ The following statement from FINRA Regulatory Notice 11-02 (January 2011) is useful:

A broker-dealer must know its customers not only at account opening but also throughout the life of its relationship with customers in order to, among other things, effectively service and supervise the customers' accounts. Since a broker-dealer's relationship with its customers is dynamic, FINRA does not believe that it can prescribe a period within which broker-dealers must attempt to update this information. As with a customer's investment profile under the suitability rule, a firm should verify the "essential facts" about a customer under the know-your-customer rule at intervals reasonably calculated to prevent and detect any mishandling of a customer's account that might result from the customer's change in circumstances. The reasonableness of a broker-dealer's efforts in this regard will depend on the facts and circumstances of the particular case. Firms should note, however, that SEA Rule 17a-3 requires broker-dealers to, among other things, attempt to update certain account information every 36 months regarding accounts for which the broker-dealers were required to make suitability determinations.

As to ARS's suggestion that the affirmation be required to be in writing, although it appears that many dealers plan to rely on written affirmations, the MSRB is not requiring that the affirmations be in writing in view of the goal to be consistent with FINRA Rule 2111 unless a different rule is justified.

General Rule. SIFMA noted that the original version of the Restated SMMP Notice would have required an attestation from each institutional customer, while FINRA Rule 2111 requires an affirmation. It asked that the MSRB language track the FINRA rule precisely and requested clarification that the FINRA Rule 2111 affirmation would suffice for the SMMP affirmation. BDA questioned how a dealer could satisfy the reasonable basis requirement of the general rule absent use of the safe harbor and suggested that the list of factors set forth in the Existing SMMP Notice be retained. It said that, at a minimum, the MSRB should make it clear that there is no negative implication to the deletion of the list and that the deletion of the list is not an indication that the considerations are no longer considered relevant by the MSRB. BDA objected to the need for attestations from investors even under the general rule and suggested that a dealer should be able to inform its customer that the dealer considers the customer to be an SMMP, capable of exercising independent judgment and evaluating market risks and market value. As to customers that qualify as SMMPs under the current notice, BDA requested that the MSRB provide a transition rule that would permit dealers six months within which to obtain the required attestations from customers that meet the current definition of SMMP. TMC questioned whether attestations from customers that meet the current definition of SMMP would be required.

The MSRB has changed the words "affirmatively attest" in the definition of SMMP to "affirmatively indicate" to track precisely the affirmation language of FINRA Rule 2111 and wishes to clarify that the FINRA Rule 2111 customer affirmation would satisfy the SMMP affirmation requirement. The MSRB has also determined to recommend that the proposed effective date of the restated SMMP notice be the same as that of FINRA Rule 2111, which is July 9, 2012. No exception from the affirmation requirement would be provided, because under FINRA Rule 2111 affirmations must be received from all institutional customers as to which dealers plan to avail themselves of the institutional customer-specific suitability exception. Companies that already provide qualified institutional buyer (QIB) lists for dealers are already in the process of obtaining the required FINRA Rule 2111 affirmations from institutional customers.

As to BDA's comment on the list of factors that the restated notice would eliminate, the factors in the existing SMMP notice may actually have the practical effect of serving as a constraint on a dealer's ability to conclude that a customer is an SMMP. The text of the existing SMMP notice that precedes the list of factors follows:

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.

Because the list of factors may actually serve as a constraint on the dealer's reasonable basis determination, when FINRA Rule 2111 eliminated a very similar list of factors, the MSRB decided to eliminate the list from the restated SMMP notice as well. This provides more flexibility to a dealer as to how it will satisfy the reasonable basis requirement of the general rule. The MSRB wishes to clarify that dealers might find those factors useful but would not be required to consider them.

6. Extension of Time Period of Commission Action

The MSRB declines to consent to an extension of the time period specified in Section 19(b)(2) of the Exchange Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2).

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

As described above, the proposed rule change is closely based on FINRA Rule 2111(b). A comparison of the restated definition of SMMP and FINRA Rule 2111 follows:¹⁵

[A member or associated person fulfills the customer-specific suitability obligation for]-**For purposes of this notice, the term "sophisticated municipal market professional" or "SMMP" shall mean** an institutional [account, as defined in NASD Rule 3110(c)(4), if (1) the member or associated person] **customer of a dealer that: (1) the dealer** has a reasonable basis to believe [that the institutional customer] is capable of evaluating investment risks **and market value** independently, both in general and with regard to particular transactions [and investment strategies involving a security or] **in municipal** securities, and (2) [the institutional customer] affirmatively indicates that it is exercising independent judgment in evaluating the [member's or associated person's] 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.**

¹⁵ Underlining indicates additions; brackets indicate deletions.

As described above, the proposed rule change would define “institutional customer” as “a customer with an institutional account,” and “institutional account” would be defined as defined in MSRB Rule G-8(a)(xi), which is the same as the definition of “institutional account” in NASD Rule 3110(c)(4). The restated definition of SMMP would introduce the concept of an institutional customer’s capability of evaluating the market value of municipal securities independently, because the restated SMMP notice applies the concept of SMMP to include a dealer’s pricing obligation under MSRB Rule G-18 and its obligations concerning quotations under Rule G-13, rather than being limited to a dealer’s suitability obligation, as is the case with FINRA Rule 2111. The other difference between the restated definition of SMMP and FINRA Rule 2111(b) is that the Restated SMMP Notice would provide that, as part of its reasonable basis analysis, the dealer should consider the amount and type of municipal securities owned or under management by the institutional customer.

9. Exhibits

1. Federal Register Notice
2. Notice Requesting Comment and Comment Letters
5. Text of Proposed Rule Change

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-MSRB-2012-05)

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of a Restatement of an Interpretive Notice Concerning the Application of MSRB Rule G-17 to Sophisticated Municipal Market Professionals

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“the Exchange Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 26, 2012, the Municipal Securities Rulemaking Board (“Board” or “MSRB”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the MSRB. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The MSRB is filing with the SEC a proposed rule change consisting of a restatement of an interpretive notice (the “Existing SMMP Notice” and the “Restated SMMP Notice,” respectively) concerning the application of MSRB Rule G-17 (on conduct of municipal securities and municipal advisory activities) to sophisticated municipal market professionals (“SMMPs”). Because of the relationship between the proposed rule change and FINRA Rule 2111 (on suitability), the MSRB requests that the proposed rule change be made effective on July 9, 2012, which is the date on which FINRA Rule 2111 will become effective.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

The text of the proposed rule change is available on the MSRB's website at www.msrb.org/Rules-and-Interpretations/SEC-Filings/2012-Filings.aspx, at the MSRB's principal office, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the MSRB included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The MSRB has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

EXISTING DEFINITION OF SMMP

Under the Existing SMMP Notice, a dealer is permitted to treat an institutional customer³ as an SMMP if the dealer has reasonable grounds for concluding the following and other known facts do not contradict such a conclusion:

- the customer has timely access to the publicly available material facts concerning a municipal securities transaction;
- the customer is capable of independently evaluating the investment risk and market value of the municipal securities at issue; and

³ For purposes of the Existing SMMP Notice, an institutional customer is defined as "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."

- the customer is making independent decisions about its investments in municipal securities.

Although the Existing SMMP Notice permits a dealer to have an investor attest to SMMP status “as a means of streamlining the dealers’ process for determining that the customer is an SMMP,” it also provides that a dealer may not rely on such an attestation if the dealer knows or has reason to know that the investor lacks sophistication concerning a municipal securities transaction based on a number of factors set forth in the notice.

Access to Material Facts. As to the first part of the definition of SMMP, access to material facts, the Existing SMMP Notice provides that a dealer’s analysis may depend on the customer’s resources to investigate the transaction (e.g., research analysts) and the customer’s ready access to established industry sources for disseminating material information concerning the transaction (e.g., the predecessors of the MSRB’s Electronic Municipal Market Access (“EMMA”) System and the MSRB’s Real-Time Trade Reporting System (“RTRS”), rating agency data, and other indicative data sources).

Independent Evaluation of Investment Risk and Market Value. As to the second part of the definition of SMMP, independent evaluation of risk and market value, the Existing SMMP Notice identifies the following relevant factors:

- the customer’s use of one or more consultants, investment advisers, research analysts or bank trust departments;
- the customer’s general level of experience in municipal securities markets and specific experience with the type of municipal securities under consideration;
- the customer’s ability to understand the economic features of the municipal security;

- the customer's ability to independently evaluate how market developments would affect the municipal security under consideration; and
- the complexity of the municipal security or securities involved.

Independent Investment Decisions. As to the third part of the definition, independent investment decisions, the Existing SMMP Notice provides that such a determination will depend on the nature of the relationship between the dealer and the institutional customer and provides that the following considerations may be relevant:

- 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.

APPLICATION OF EXISTING SMMP DEFINITION

The Existing SMMP Notice addresses a dealer's obligations to an SMMP under Rule G-17 (on fair dealing), Rule G-18 (on execution of transactions), Rule G-19 (on suitability), and Rule G-13 (on quotations).

Rule G-17. Just prior to the adoption of the Existing SMMP Notice, the SEC approved another MSRB notice⁴ in which the MSRB interpreted Rule G-17 to require brokers, dealers, and municipal securities dealers (“dealers”) to disclose to customers at or before the time of trade all material facts about a transaction known by the dealer, as well as all material facts about a security reasonably accessible to the market from established industry sources.⁵ The Existing SMMP Notice provides that, when a dealer effects a non-recommended secondary market transaction with an SMMP, its affirmative Rule G-17 disclosure duty concerning material facts available from established industry sources will be deemed satisfied. The Existing SMMP Notice does not 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, it puts the dealer’s disclosure obligations to SMMPs when effecting non-recommended secondary market transactions on a par with inter-dealer disclosure obligations. The Existing SMMP Notice provides that, 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.

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

⁴ MSRB Interpretive Notice Regarding Rule G-17, On Disclosure of Material Facts (March 20, 2002) (the “2002 Rule G-17 Notice”).

⁵ The 2002 Rule G-17 Notice was updated in 2009 to reflect, among other things, the addition of EMMA as an established industry source. See MSRB Guidance On Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities (July 14, 2009). The 2009 Notice also extended the Rule G-17 affirmative disclosure obligation to “material information.”

conditions. The Existing SMMP Notice provides that a dealer effecting a non-recommended secondary market agency transaction to an SMMP is not required to take further actions to ensure that the transaction is effected at a fair and reasonable price, if 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 Existing SMMP Notice then states that this interpretation of Rule G-18 is particularly relevant to dealers operating alternative trading systems, stating that dealers operating such systems may be merely aggregating the buy and sell interest of other dealers or SMMPs. A footnote to the Existing SMMP Notice says that the same interpretation would apply to a broker's broker when executing an agency transaction for another dealer.

Rule G-19. Under Rule G-19, in the case of a recommended transaction, a dealer must have a reasonable basis for recommending a particular security ("reasonable-basis suitability"), as well as reasonable grounds for believing the recommendation is suitable for the customer to whom it is made, 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 ("customer-specific suitability"). The Existing SMMP Notice provides that, when a dealer has reasonable grounds for concluding that an institutional customer is an SMMP, the dealer's customer-specific suitability obligation is fulfilled.

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. 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.

The Existing SMMP Notice provides that, if a dealer disseminates the quotation of an SMMP and it is labeled as such, the disseminating dealer will be held to the same standard as if it were disseminating a quotation made by another dealer. The notice says that the following factors are relevant to the dealer's assessment of whether dissemination of the SMMP's quotation may be considered to be a violation of Rule G-13 by the dealer: (i) complaints received from dealers and investors seeking to execute against such quotations, (ii) a pattern of an 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 an SMMP effecting transactions at prices that depart materially from the prices listed in the quotations in a manner that consistently is favorable to the SMMP making the quotation.

CONSIDERATIONS FOR CHANGE

Increased Availability of Information about Municipal Securities. In 2002, the MSRB decided to adopt a definition of SMMP that differed from certain other regulatory definitions of

investors considered sophisticated enough to receive special treatment under the federal securities law. The SMMP definition was closely modeled on an NASD interpretation of its suitability rule,⁶ which contained a comparable list of factors found relevant to an investor's independent evaluation of risk and independent investment decisions. A notable difference was that the definition of SMMP also looked to whether the investor had access to material facts. A key factor in the MSRB's decision was the lack of information available about municipal securities at that time. Since the adoption of the existing definition of SMMP, there has been a vast increase in the availability of information about municipal securities reasonably accessible by institutional investors regardless of the amount of their holdings of municipal securities (e.g., on EMMA, from rating agencies, and from other information vendors).

New FINRA Institutional Suitability Rule. Effective July 9, 2012, the NASD guidance on institutional suitability will no longer be in effect. It will be replaced by FINRA Rule 2111, which adopts a different approach to a FINRA member's customer-specific duty of suitability to an "institutional account."⁷ Under FINRA Rule 2111, a dealer's customer-specific suitability obligation to an institutional customer will be considered satisfied if (1) the dealer has a reasonable basis to believe that the institutional customer is capable of evaluating investment

⁶ See IM-2310-3. Suitability Obligations to Institutional Customers.

⁷ The term "institutional account" will be defined in the same manner as under MSRB Rule G-8(a)(xi). MSRB 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.

risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the dealer's recommendations. There will no longer be a detailed listing of factors, such as that found in the Existing SMMP Notice. The MSRB generally considers it desirable from the standpoint of reducing the cost of dealer compliance to maintain consistency with FINRA rules, absent clear reasons for treating transactions in municipal securities differently.

PROPOSAL TO RESTATE SMMP NOTICE

Revised Definition of SMMP. Because the quality and availability of information concerning municipal securities has improved substantially since 2002, and to maintain consistency with the revised FINRA suitability rule for institutional customers, the MSRB proposes to retain the concept of an SMMP, but revise its definition so that it is consistent with the new FINRA suitability rule for institutional customers. Specifically, the MSRB proposes that an "SMMP" be defined as an "institutional customer⁸ 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."

The MSRB also proposes to include the following statement in the Restated SMMP Notice's discussion of the definition of SMMP: "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."

⁸ "Institutional customer" would be defined as a customer with an institutional account (as defined under MSRB Rule G-8(a)(xi)).

The key to the revised definition of SMMP is the requirement that a dealer have a reasonable basis to believe that an investor is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions in municipal securities (sometimes referred to in this filing as the “reasonable basis analysis”). When the MSRB created the existing definition of SMMP, alternative trading systems for municipal securities were new and access to material facts about municipal securities was in large part limited to very large institutional investors. The high threshold for determining whether an investor would be considered an institutional customer under the Existing SMMP Notice (\$100 million of municipal securities owned and/or under management) was considered necessary to make sure that only the most sophisticated institutions and dealers were likely to use alternative trading systems. The Restated SMMP Notice would provide that, as part of its reasonable basis analysis, a dealer should consider the amount and type of municipal securities owned or under management by the institutional customer. However, there would no longer be a threshold requirement that a customer own or manage a certain amount of municipal securities in order to be considered an SMMP.

The MSRB also proposes that, in the case of the affirmation described in clause (2) of the revised definition of SMMP (i.e., “capable of evaluating investment risks and market value independently”), customers be allowed to make the affirmation orally or in writing and to provide the affirmation on a trade-by-trade basis, on a type-of-municipal-security basis (e.g., general obligation, revenue, VRDO, etc.), or for all potential transactions for the customer’s account. This would be consistent with the affirmation requirement of FINRA Rule 2111, so receipt by a dealer of the FINRA 2111 affirmation would also satisfy this requirement.

Application of Revised SMMP Definition. The Restated SMMP Notice would not change the application of Rules G-18, G-19, and G-13 to SMMPs. However, it would change the application of Rule G-17 to SMMPs, under the assumption that institutional customers now have substantial access to material information about municipal securities. The Existing SMMP Notice limits the exclusion from the duty to disclose all material facts to SMMPs to non-recommended transactions. The Restated SMMP Notice would apply the exclusion to all transactions with SMMPs, whether recommended or self-directed. The Restated SMMP Notice would also remove the lists of factors that were deemed by the Board in 2002 to be relevant to the components of the original definition of SMMP. It would also update the Existing SMMP Notice to reflect developments in the MSRB's interpretations of Rule G-17 since 2002 and remove endnote 9 to the Existing SMMP Notice, which has been construed by some to lessen the duty of a broker's broker under Rule G-18 in a manner that is inconsistent with the Board's proposed Rule G-43 (on broker's brokers).⁹ Furthermore, it would remove the language that suggests that transactions on alternative trading systems are done on an agency basis, because at least one major alternative trading system engages only in principal transactions.

2. Statutory Basis

The MSRB believes that the proposed rule change is consistent with Section 15B(b)(2) of the Securities Exchange Act ("Exchange Act"), which provides that:

The Board shall propose and adopt rules to effect the purposes of this title with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers and advice provided to or on behalf of municipal entities or obligated persons by brokers, dealers, municipal securities dealers, and municipal advisors with respect to municipal financial products, the issuance of

⁹ File No. SR-MSRB-2012-04 (March 5, 2012). The MSRB notes that, under proposed Rule G-43(d)(iii)(A), an alternative trading system that had any customers (as defined in MSRB Rule D-9) that were not SMMPs would not be excepted from the definition of "broker's broker."

municipal securities, and solicitations of municipal entities or obligated persons undertaken by brokers, dealers, municipal securities dealers, and municipal advisors.

Section 15B(b)(2)(C) of the Exchange Act, provides that the rules of the MSRB shall:

be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest.

The proposed rule change is consistent with Sections 15B(b)(2) and 15B(b)(2)(C) of the Exchange Act. Its principal purpose is to remove impediments to and perfect the mechanism of a free and open market in municipal securities, particularly in the case of the alternative trading systems that have been an increasingly important venue for the provision of secondary market liquidity for municipal securities. New municipal securities products, such as Build America Bonds, and decreasing spreads between interest rates on Treasury bonds and municipal securities, have attracted investors that were not previously invested in municipal securities to the municipal securities market. At the same time, the amount of available information about municipal securities has vastly increased since the Existing SMMP Notice was approved. While the Restated SMMP Notice would provide that a dealer should consider the amount and type of municipal securities owned or under management by the institutional customer, the MSRB no longer considers it essential that an institutional customer own or manage municipal securities in order to engage in informed decisionmaking about municipal securities investments. The MSRB believes it is appropriate to allow sophisticated investors to trade in municipal securities on alternative trading systems even though they do not meet the \$100 million threshold of municipal securities owned and/or managed found in the Existing SMMP Notice. This change would not

come at the expense of investor protection. While the application of the proposed rule change would not be limited to transactions on alternative trading systems, the application of certain MSRB rules to such systems has proven difficult in practice, especially with the increasing use of computerized algorithmic trading. The MSRB notes that such systems, if monitored closely and subjected to appropriate rulemaking,¹⁰ have the potential to increase pre-trade transparency in the municipal marketplace, which should eventually improve prices for all investors. The MSRB also generally considers it desirable from the standpoint of reducing the cost of dealer compliance to maintain consistency with FINRA rules, absent clear reasons for treating transactions in municipal securities differently.

B. Self-Regulatory Organization's Statement on Burden on Competition

The MSRB does not believe that the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, since it would apply equally to all dealers that have SMMP customers, whether alternative trading systems or not.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

On November 8, 2011, the MSRB requested comment on the original version of the proposed rule change.¹¹ The MSRB received comment letters from (1) Alternative Regulatory Solutions, LLC ("ARS"); (2) Bond Dealers of America ("BDA"); (3) Securities Industry and Financial Markets Association ("SIFMA"); and (4) TMC Bonds L.L.C. ("TMC"), formerly The MuniCenter.

¹⁰ The MSRB notes that proposed MSRB Rule G-43 would provide for additional regulation of such alternative trading systems.

¹¹ See MSRB Notice 2011-63 (November 8, 2011).

Safe Harbor. The original version of the Restated SMMP Notice on which comment was requested proposed a safe harbor for satisfaction of the dealer's reasonable basis analysis. Most of the comments concerned that safe harbor. The reasonable basis analysis portion of the definition of SMMP is referred to in this discussion of comments as the "general rule." SIFMA said that the safe harbor was too restrictive. It requested that: (1) the types of assets owned or under management required by the safe harbor not be limited to municipal securities, and (2) the attestation requirement of the safe harbor¹² either be eliminated entirely or eliminated for certain types of institutional customers (i.e., banks, savings and loan associations, insurance companies, registered investment companies, and federally- or state-registered investment advisers). SIFMA said that, if the assets required for the safe harbor were required to be municipal securities, the dollar threshold should be reduced from \$50 million to \$25 million of municipal securities owned or under management. TMC said that the safe harbor should require ownership and/or management of at least \$50 million of direct fixed income securities. BDA advocated that an institutional investor with at least \$25 million of fixed income securities should qualify for the safe harbor without the need for an attestation. ARS recommended that the attestations of the general rule and the safe harbor be combined and that all attestations be required to be in writing. ARS also recommended that the safe harbor requirement of \$50 million of municipal securities be determined on an average annual basis and asked how often a dealer would be required to verify this asset concentration.

The MSRB has determined to eliminate the safe harbor from the proposed rule due to a concern that the amount of municipal securities owned or managed by a customer does not

¹² Both the general rule and the safe harbor contained "attestation" requirements, unlike the version of the SMMP definition in the proposed rule change.

necessarily equate to sophistication. Nevertheless, the Restated SMMP Notice would provide that, as part of its reasonable basis analysis, a dealer should consider the amount and type of municipal securities owned or under management by an institutional customer.

As to ARS's comment concerning the frequency with which the \$50 million threshold of the safe harbor would need to be measured, while the safe harbor has been eliminated, the question is still relevant to the frequency with which dealers would need to take steps to reassess their reasonable basis determinations with respect to their institutional customers. Dealers should monitor their reasonable basis determinations as frequently as they consider prudent, just as they would need to do so if they planned to treat natural persons with total assets of at least \$50 million as institutional customers under either FINRA Rule 2111 or the Restated SMMP Notice.¹³

As to ARS's suggestion that the affirmation be required to be in writing, although it appears that many dealers plan to rely on written affirmations, the MSRB is not requiring that the

¹³ The following statement from FINRA Regulatory Notice 11-02 (January 2011) is useful:

A broker-dealer must know its customers not only at account opening but also throughout the life of its relationship with customers in order to, among other things, effectively service and supervise the customers' accounts. Since a broker-dealer's relationship with its customers is dynamic, FINRA does not believe that it can prescribe a period within which broker-dealers must attempt to update this information. As with a customer's investment profile under the suitability rule, a firm should verify the "essential facts" about a customer under the know-your-customer rule at intervals reasonably calculated to prevent and detect any mishandling of a customer's account that might result from the customer's change in circumstances. The reasonableness of a broker-dealer's efforts in this regard will depend on the facts and circumstances of the particular case. Firms should note, however, that SEA Rule 17a-3 requires broker-dealers to, among other things, attempt to update certain account information every 36 months regarding accounts for which the broker-dealers were required to make suitability determinations.

affirmations be in writing in view of the goal to be consistent with FINRA Rule 2111 unless a different rule is justified.

General Rule. SIFMA noted that the original version of the Restated SMMP Notice would have required an attestation from each institutional customer, while FINRA Rule 2111 requires an affirmation. It asked that the MSRB language track the FINRA rule precisely and requested clarification that the FINRA Rule 2111 affirmation would suffice for the SMMP affirmation. BDA questioned how a dealer could satisfy the reasonable basis requirement of the general rule absent use of the safe harbor and suggested that the list of factors set forth in the Existing SMMP Notice be retained. It said that, at a minimum, the MSRB should make it clear that there is no negative implication to the deletion of the list and that the deletion of the list is not an indication that the considerations are no longer considered relevant by the MSRB. BDA objected to the need for attestations from investors even under the general rule and suggested that a dealer should be able to inform its customer that the dealer considers the customer to be an SMMP, capable of exercising independent judgment and evaluating market risks and market value. As to customers that qualify as SMMPs under the current notice, BDA requested that the MSRB provide a transition rule that would permit dealers six months within which to obtain the required attestations from customers that meet the current definition of SMMP. TMC questioned whether attestations from customers that meet the current definition of SMMP would be required.

The MSRB has changed the words “affirmatively attest” in the definition of SMMP to “affirmatively indicate” to track precisely the affirmation language of FINRA Rule 2111 and wishes to clarify that the FINRA Rule 2111 customer affirmation would satisfy the SMMP affirmation requirement. The MSRB has also determined to recommend that the proposed

effective date of the restated SMMP notice be the same as that of FINRA Rule 2111, which is July 9, 2012. No exception from the affirmation requirement would be provided, because under FINRA Rule 2111 affirmations must be received from all institutional customers as to which dealers plan to avail themselves of the institutional customer-specific suitability exception. Companies that already provide qualified institutional buyer (QIB) lists for dealers are already in the process of obtaining the required FINRA Rule 2111 affirmations from institutional customers.

As to BDA's comment on the list of factors that the restated notice would eliminate, the factors in the existing SMMP notice may actually have the practical effect of serving as a constraint on a dealer's ability to conclude that a customer is an SMMP. The text of the existing SMMP notice that precedes the list of factors follows:

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.

Because the list of factors may actually serve as a constraint on the dealer's reasonable basis determination, when FINRA Rule 2111 eliminated a very similar list of factors, the MSRB decided to eliminate the list from the restated SMMP notice as well. This provides more flexibility to a dealer as to how it will satisfy the reasonable basis requirement of the general rule. The MSRB wishes to clarify that dealers might find those factors useful but would not be required to consider them.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or

within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-MSRB-2012-05 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-MSRB-2012-05. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the

proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the MSRB's offices. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2012-05 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁴

Elizabeth M. Murphy
Secretary

¹⁴ 17 CFR 200.30-3(a)(12).



MSRB NOTICE 2011-63 (NOVEMBER 8, 2011)

REQUEST FOR COMMENT ON RESTATED SOPHISTICATED MUNICIPAL MARKET PROFESSIONAL NOTICE

The Municipal Securities Rulemaking Board (“MSRB”) is requesting comment on a restatement of its 2002 notice on “sophisticated municipal market professionals” or “SMMPs” (the “Restated SMMP Notice”). Comments should be submitted no later than December 13, 2011 and may be submitted in electronic or paper form. Electronic comments may be submitted via email to CommentLetters@msrb.org. Please indicate the notice number in the subject line of the email and, if possible, send comments in PDF format. Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1900 Duke Street, Suite 600, Alexandria, VA 22314. All comments will be available for public inspection on the MSRB’s website.^[1]

Questions about this notice should be directed to Peg Henry, General Counsel, Market Regulation, at 703-797-6600.

BACKGROUND

The MSRB is engaged in a review of the electronic trading systems^[2] on which municipal securities may be traded to determine whether guidance it issued on such systems in 2001 and 2002 should be updated to reflect subsequent changes in the municipal securities market and such systems. Each of the principal electronic trading systems has some institutional customers. Accordingly, the MSRB has been reconsidering its 2002 guidance^[3] on the institutional customers that use such systems (the “Existing SMMP Notice”). Although the Existing SMMP Notice was developed in large part because of electronic trading systems, it is not limited in scope to electronic trading systems.

EXISTING DEFINITION OF SMMP

Under the Existing SMMP Notice, a dealer is permitted to treat an institutional customer^[4] as an SMMP if the dealer has reasonable grounds for concluding the following and other known facts do not contradict such a conclusion:

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

Although the Existing SMMP Notice permits a dealer to have an investor attest to SMMP status “as a means of streamlining the dealers’ process for determining that the customer is an SMMP,” it also provides that a dealer may not rely on such an attestation if the dealer knows or has reason to know that the investor lacks sophistication concerning a municipal securities transaction based on a number of factors set forth in the notice.

Access to Material Facts. As to the first part of the definition of SMMP, access to material facts, the Existing SMMP Notice provides that a dealer’s analysis may

depend on the customer's resources to investigate the transaction (e.g., research analysts) and the customer's ready access to established industry sources for disseminating material information concerning the transaction (e.g., the predecessors of the MSRB's Electronic Municipal Market Access ("EMMA") System and the MSRB's Real-Time Trade Reporting System ("RTRS"), rating agency data, and other indicative data sources).

Independent Evaluation of Investment Risk and Market Value. As to the second part of the definition of SMMP, independent evaluation of risk and market value, the Existing SMMP Notice identifies the following relevant factors:

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

Independent Investment Decisions. As to the third part of the definition, independent investment decisions, the Existing SMMP Notice provides that such a determination will depend on the nature of the relationship between the dealer and the institutional customer and provides that the following considerations may be relevant:

- 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.

APPLICATION OF EXISTING SMMP DEFINITION

The Existing SMMP Notice addresses a dealer's obligations to an SMMP under Rule G-17 (on fair dealing), Rule G-18 (on execution of transactions), Rule G-19 (on suitability), and Rule G-13 (on quotations).

Rule G-17. Just prior to the adoption of the Existing SMMP Notice, the SEC approved another MSRB notice^[5] in which the MSRB interpreted Rule G-17 to require dealers to disclose to customers at or before the time of trade all material facts about a transaction known by the dealer, as well as all material facts about a security reasonably accessible to the market from established industry sources.^[6] The Existing SMMP Notice provides that, when a dealer effects a non-recommended secondary market transaction with an SMMP, its affirmative Rule G-17 disclosure duty concerning material facts available from established industry sources will be deemed satisfied. The Existing SMMP Notice does not 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, it puts the dealer's disclosure obligations to SMMPs when effecting non-

recommended secondary market transactions on a par with inter-dealer disclosure obligations. The Existing SMMP Notice provides that, 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.

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 Existing SMMP Notice provides that a dealer effecting a non-recommended secondary market agency transaction to an SMMP is not required to take further actions to ensure that the transaction is effected at a fair and reasonable price, if 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 Existing SMMP Notice then states that this interpretation of Rule G-18 is particularly relevant to dealers operating alternative trading systems, stating that dealers operating such systems may be merely aggregating the buy and sell interest of other dealers or SMMPs. A footnote to the Existing SMMP Notice says that the same interpretation would apply to a broker's broker when executing an agency transaction for another dealer.

Rule G-19. Under Rule G-19, in the case of a recommended transaction, a dealer must have a reasonable basis for recommending a particular security ("reasonable-basis suitability"), as well as reasonable grounds for believing the recommendation is suitable for the customer to whom it is made, 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 ("customer-specific suitability"). The Existing SMMP Notice provides that, when a dealer has reasonable grounds for concluding that an institutional customer is an SMMP, the dealer's customer-specific suitability obligation is fulfilled.

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. 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.

The Existing SMMP Notice provides that, if a dealer disseminates the quotation of an SMMP and it is labeled as such, the disseminating dealer will be held to the same standard as if it were disseminating a quotation made by another dealer. The notice says that the following factors are relevant to the dealer's assessment of whether dissemination of the SMMP's quotation may be considered to be a violation of Rule G-

13 by the dealer: (i) complaints received from dealers and investors seeking to execute against such quotations, (ii) a pattern of an 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 an SMMP effecting transactions at prices that depart materially from the prices listed in the quotations in a manner that consistently is favorable to the SMMP making the quotation.

CONSIDERATIONS FOR CHANGE

Increased Availability of Information about Municipal Securities. In 2002, the MSRB decided to adopt a definition of SMMP that differed from certain other regulatory definitions of investors considered sophisticated enough to receive special treatment under the federal securities law. The SMMP definition was closely modeled on an NASD interpretation of its suitability rule,^[7] which contained a comparable list of factors found relevant to an investor's independent evaluation of risk and independent investment decisions. A notable difference was that the definition of SMMP also looked to whether the investor had access to material facts. A key factor in the MSRB's decision was the lack of information available about municipal securities at that time. Since the adoption of the existing definition of SMMP, there has been a substantial increase in the availability of information about municipal securities reasonably accessible by institutional investors regardless of the amount of their holdings of municipal securities (e.g., on EMMA, from rating agencies, and from other information vendors).

New FINRA Institutional Suitability Rule. Effective July 9, 2012, the NASD guidance on institutional suitability will no longer be in effect. It will be replaced by FINRA Rule 2111, which adopts a different approach to a FINRA member's customer-specific duty of suitability to an "institutional account."^[8] Under FINRA Rule 2111, a dealer's customer-specific suitability obligation to an institutional customer will be considered satisfied if (1) the dealer has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the dealer's recommendations. There will no longer be a detailed listing of factors, such as that found in the Existing SMMP Notice. The MSRB generally considers it desirable from the standpoint of reducing the cost of dealer compliance to maintain consistency with FINRA rules, absent clear reasons for treating transactions in municipal securities differently.

PROPOSAL TO RESTATE SMMP NOTICE

The MSRB is proposing to restate the Existing SMMP Notice as follows:

Revised Definition of SMMP. Because the quality and availability of information concerning municipal securities has improved substantially since 2002, and to maintain consistency with the revised FINRA suitability rule for institutional customers, the MSRB proposes to retain the concept of an SMMP, but revise its definition so that it is consistent with the new FINRA suitability rule for institutional customers. Specifically, the MSRB proposes that an "SMMP" be defined as an "institutional customer^[9] 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 attests that it is exercising independent judgment in evaluating the recommendations of the dealer."

The MSRB also proposes that there be a safe harbor that will allow a dealer to satisfy the "reasonable basis" requirement of clause (1) of the SMMP definition, if: (i) the

institutional customer has total assets of at least \$50 million invested in municipal securities in the aggregate in its portfolio and/or under management, and (ii) the institutional customer attests that it is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions in municipal securities.

The key to the revised definition of SMMP is the requirement that a dealer have a reasonable basis to believe that an investor is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions in municipal securities. When the MSRB created the existing definition of SMMP, electronic trading systems for municipal securities were new and access to material facts about municipal securities was in large part limited to very large institutional investors. The high threshold for determining whether an investor would be considered an institutional customer under the Existing SMMP Notice (\$100 million of municipal securities owned or under management) was considered necessary to make sure that only the most sophisticated institutions and dealers were likely to use electronic trading systems. Under the revised definition, the amount of an investor's assets and their nature is less important. Although undoubtedly relevant to whether a dealer would have a reasonable basis for concluding that an institutional customer is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions in municipal securities, a dealer could meet the reasonable basis requirement through other means. The amount of municipal securities owned or managed by an investor would become a safe harbor for the reasonable basis requirement, rather than a threshold requirement for establishing whether an investor is an institutional customer.

The MSRB also proposes that, in the case of either of the attestations described above (*i.e.*, "capable of evaluating investment risks and market value independently" and "exercising independent judgment in evaluating recommendations"), customers be allowed to make the attestation orally or in writing and to provide the attestation on a trade-by-trade basis, on a type-of-municipal-security basis (*e.g.*, general obligation, revenue, VRDO, etc.), or for all potential transactions for the customer's account.

Application of Revised SMMP Definition. The Restated SMMP Notice would not change the application of Rules G-18, G-19, and G-13 to SMMPs. However, it would change the application of Rule G-17 to SMMPs, under the assumption that institutional customers now have substantial access to material information about municipal securities. The Existing SMMP Notice limits the exclusion from the duty to disclose all material facts to SMMPs to non-recommended transactions. The Restated SMMP Notice would apply the exclusion to all transactions with SMMPs, whether recommended or self-directed. The Restated SMMP Notice would also remove the lists of factors that were deemed by the Board in 2002 to be relevant to the components of the original definition of SMMP. It would also update the Existing SMMP Notice to reflect developments in the MSRB's interpretations of Rule G-17 since 2002 and remove endnote 9 to the Existing SMMP Notice, which has been construed by some to lessen the duty of a broker's broker under Rule G-18 in a manner that is inconsistent with the Board's proposed Rule G-43. Furthermore, it would remove the language that suggests that transactions on alternative trading systems are done on an agency basis, because at least one major electronic trading system engages only in principal transactions.

REQUEST FOR COMMENT

The MSRB requests comments on the Restated SMMP Notice.

November 8, 2011

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

~~Industry participants have suggested that the~~ The MSRB's fair practice rules should allow dealers[1] 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" 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 attests that it is exercising independent judgment in evaluating the recommendations of the dealer. A dealer shall be deemed to have established the reasonable basis required by clause (1) if: (i) the institutional customer has total assets of at least \$40050 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 , and (ii) the institutional customer affirmatively attests that it is capable of evaluating 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”).~~ independently, both in general and with regard to particular transactions in municipal securities. A customer may make either attestation described in this paragraph either orally or in writing and may provide the attestation 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, ~~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~~ affect how such quotation is treated under ~~rule~~ Rule G-13.

~~Considerations Regarding The Identification Of Sophisticated Municipal Market Professionals~~

Application of SMMP Concept to Rule G-17

~~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.~~ 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]

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®) system[3] 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 However, 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 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~~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 a par with inter-dealer disclosure obligations. This interpretation will be particularly relevant to dealers operating electronic trading ~~platforms~~systems, although it will also apply to dealers ~~who~~that 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~~when the information is not accessible through established industry sources, may constitute an unfair practice ~~violative of rule~~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 Interpretation—Duty to Ensure That Agency Transactions Are Effected at Fair and Reasonable Prices~~

Rule G-18 ~~requires~~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.^[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 electronic 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 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~~ 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~~ 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~~ 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 electronic 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 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~~ 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~~Rule G-19 to have a “reasonable basis” to believe that the recommendation could be suitable for at least some customers.^{[10][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~~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~~ 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 is presumed to be a quotation made by such dealer. In addition, any “quotation” of a non-dealer (e.g., including the quotation of 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 the dealer.^[11] The and the dealer is affirmatively responsible in either case for ensuring compliance with the *bona fide* and fair market value requirements with respect to such 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. Furthermore, if 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.^{[12][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~~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]~~[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.~~[14]~~[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~~.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 20, 2002).

[4] The Securities and Exchange Commission (“SEC”) has 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*, Exchange Act Release No. 26100 (September 22, 1988) at note 76, quoting *In re Walston & Co. Inc., and Harrington*, Exchange Act Release No. 8165 (September 22, 1967).

~~[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~~

[5] See e.g., [Notice Concerning the Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer's Advertisements \(May 7, 1985\)](#); *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.~~

[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.

~~[12] [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.~~

~~[13] [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 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. [Rule G-21 Interpretive Letter – Disclosure Obligations \(May 21, 1998\)](#).

~~[14] [9] 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. [Notice of Interpretation of Rule G-13 on Published Quotations \(April 21, 1988\)](#).~~

[1] Comments are posted on the MSRB website without change. Personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should submit only information that they wish to make available publicly.

[2] The term “electronic trading system” refers to multi-dealer platforms registered as brokers, dealers, or municipal securities dealers (“dealers”) and subject to regulation by the Securities and Exchange Commission (“SEC”) as alternative trading systems (“ATSs”). Dealers and institutional customers are the principal users of such systems. The term “electronic trading system” is to be contrasted with the term “electronic brokerage system,” which refers to single-dealer platforms owned by registered dealers to which retail customers are permitted access.

[3] [Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals \(April 30, 2002\)](#).

[4] For purposes of the Existing SMMP Notice, an institutional customer is defined as “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.”

[5] [Interpretive Notice Regarding Rule G-17, On Disclosure of Material Facts \(March 20, 2002\)](#) (the “2002 Rule G-17 Notice”).

[6] The 2002 Rule G-17 Notice was updated in 2009 to reflect, among other things, the addition of EMMA as an established industry source. See [Guidance On Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities \(July 14, 2009\)](#). The 2009 Notice also extended the Rule G-17 affirmative disclosure obligation to “material information”.

[7] See IM-2310-3. Suitability Obligations to Institutional Customers.

[8] The term “institutional account” will be defined in the same manner as under MSRB Rule G-8(a)(xi). MSRB 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.

[9] “Institutional customer” is defined as a customer with an institutional account (as defined under MSRB Rule G-8(a)(xi)).

Alphabetical List of Comments on MSRB Notice 2011-63 (November 8, 2011)

1. Alternative Regulatory Solutions, L.L.C.: Letter from Kimberly McManus, President, dated December 13, 2011
2. Bond Dealers of America: Letter from Michael Nicholas, CEO, dated December 13, 2011
3. Securities Industry and Financial Markets Association: Letter from David L. Cohen, Managing Director, Associate General Counsel, dated December 13, 2011
4. TMC Bonds L.L.C.: Letter from John S. Craft, Director of Sales and Marketing, dated December 13, 2011



Alternative Regulatory Solutions, LLC
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973-845-6660
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December 13, 2011

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: MSRB Notice 2011-63: Request for Comment, Restated Sophisticated Municipal Market Professional

Dear Mr. Smith:

Alternative Regulatory Solutions, LLC ("ARS"), a fixed income compliance firm specializing in municipals, is pleased to have this opportunity to comment on the Proposed Restated Sophisticated Municipal Market Professional Notice (the "Notice").

ARS is in agreement with the Municipal Securities Rulemaking Board's ("MSRB") reasons for and reconsideration of its 2002 notice on sophisticated municipal market professionals ("SMMP"). ARS agrees that it is especially important to maintain consistency with the revised FINRA suitability rule for institutional customers that will become effective on July 9, 2012.

ARS has a few comments for the MSRB to consider regarding changes to the aforementioned section under 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 attests that it is exercising independent judgment in evaluating the recommendations of the dealer. A dealer shall be deemed to have established the reasonable basis required by clause (1) if: (i) the institutional customer has total assets of at least \$50 million invested in municipal securities in the aggregate in its portfolio and/or under management, and (ii) the institutional customer affirmatively attests that it is capable of evaluating investment risk and market value

independently, both in general and with regard to particular transactions in municipal securities. A customer may make either attestation described in this paragraph either orally or in writing and may provide the attestation 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.

ARS Comments:

- The requirement of 2 attestations (“capable of evaluating investment risk and market value independently” and “exercising independent judgment in evaluating recommendations”) described separately in the new rule requirement is a bit confusing. Perhaps the MSRB would consider requiring 1 attestation to cover both points (see below for recommendation).
- In an extremely volatile municipal market, an SMMP’s assets invested in municipal securities may periodically fall below the required \$50 million if customers decide to sell their municipals at a given point in time. ARS recommends that perhaps this threshold be reduced or be determined on an annual average basis.
 - Also, is it the MSRB’s intention that this asset concentration be verified prior to each municipal transaction, or just at the onset of obtaining SMMP status?
- In real life, an oral attestation is difficult to prove to regulators. It is our opinion that for each SMMP, at the onset of classifying a customer as such, 1 general written attestation be required as follows:
 - affirm the customer is capable of evaluating investment risk and market value independently, both in general and with regard to particular transactions in municipal securities. AND
 - affirm the customer is exercising independent judgment in evaluating the dealer’s recommendations.

Then, only if necessary, an oral confirmation should be utilized prior to each municipal transaction to ensure that these stipulations (including total amount invested in municipals) are still current and accurate.

It is our opinion that these slight modifications will clarify exactly what broker dealers are expected to maintain on file to demonstrate the SMMP status of their institutional clients.

Thank you for your consideration regarding the above mentioned comments. If you have any questions or wish to discuss this further, please contact me at 973.845.6660.

Regards,



Kimberly McManus
President
Alternative Regulatory Solutions, LLC



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Washington, DC 20036
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December 13, 2011

VIA ELECTRONIC MAIL

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street
Suite 600
Alexandria, VA 22314

Re: MSRB Notice 2011-63 - Request for Comment on Restated Sophisticated Municipal Market Professional Notice

Dear Mr. Smith:

The Bond Dealers of America (the “BDA”) is pleased to offer comments to the Restated Sophisticated Municipal Market Professional Notice (“Proposed Restatement”). The BDA is a Washington, DC-based organization that represents securities dealers and banks primarily active in the U.S. fixed income markets. The BDA’s members include dealers that operate electronic trading systems.

The BDA commends the Municipal Securities Rulemaking Board (“MSRB”) for recognizing the significant changes that have occurred in the municipal market, such as the MSRB’s own efforts to provide information through EMMA and the growth of electronic trading. As the MSRB notes in the Proposed Restatement, the increased availability of information allows for a revision of the definition of a Sophisticated Municipal Market Professional (“SMMP”). We believe that the regulation of the municipal market should be informed by and evolve with the market itself.

We do, however, have some comments that we believe would improve the Proposed Restatement and make its implementation easier.

The proposed safe harbor would require an SMMP to have at least \$50 million invested in municipal securities in the aggregate in its portfolio and/or under management. First, we believe that the amount could be lower than \$50 million and still reflect that the investor is able to make independent judgments. We note that the requirement for Accredited Investors requires a net worth as low as \$2 million, and the SEC has determined that those investors are sophisticated enough to purchase

a variety of unregistered securities, including stock. While we do not advocate reducing the level of SMMP assets as low as the level for Accredited Investors, we do think that it could be reduced below \$50 million, to perhaps \$25 million.

We also believe that the requirement should be that an SMMP have the required amount invested in *fixed-income securities*, not necessarily municipal securities. Any investor with at least \$50 million, or \$25 million, in fixed-income assets will have the capacity to evaluate investment risk and market value. The requirement that the assets be fixed-income will assure familiarity with the characteristics of bonds. Large cross-over purchasers of tax-exempt bonds and purchasers of taxable municipal bonds, such as Build America Bonds, who might not have the required amount in municipal securities alone, are nevertheless of a size and sophistication to make the required judgments.

We also note that the Proposed Restatement provides that the safe harbor is not the only method by which a dealer could come to the conclusion that the customer is independently capable of evaluating investment risk and market value, but that the dealer can meet the requirement “through other means.” However, the Proposed Restatement does not say what those other means might be. In fact, the Proposed Restatement deletes the section of the existing notice that gives a nonexclusive list of relevant considerations that could be used in determining that a customer is capable of independently evaluating investment risk and market value. We believe that retaining the list would be useful. At a minimum, the MSRB should make clear that there is no negative implication to the deletion of the list and that the deletion is not an indication that the considerations are no longer considered to be relevant by the MSRB.

Finally, we note that in all cases under the proposal the dealer must obtain an attestation from the customer, whether the safe harbor is used or not. If the dealer wishes to avail itself of the safe harbor, it must obtain an attestation from the customer that the customer is capable of evaluating investment risks and market value independently. If the dealer is not using the safe harbor, it must obtain an attestation from the customer that the customer is exercising independent judgment in evaluating the recommendations of the dealer.

We welcome the flexibility of being able to obtain the attestation either orally or in writing and to have it be as narrow as for a single transaction or as broad as for all potential transactions. By allowing the flexibility, the MSRB recognizes the sophisticated nature of the participants.

However, we question the practical utility of the attestations and believe that they elevate form over substance. If the investor with these substantial levels of assets is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions in municipal securities, then it seems to follow that they will do so. A more practical approach would seem to be that the dealer inform the customer that the dealer considers them to be an SMMP, capable of exercising independent judgment and evaluating market risks and market value.

If the MSRB determines that attestations will be required, we are concerned about the burden and timing of obtaining the attestations for customers where the dealer has determined under the existing notice that the customers are SMMPs. Any customer that meets the current standards would meet the standards

under the Proposed Restatement. Therefore, we urge the MSRB to provide a transition rule and allow dealers 6 months to obtain the required attestations for customers that the dealer has determined meet the SMMP requirements under the existing notice.

Thank you for the opportunity to comment on the Proposed Notice.

Sincerely,

A handwritten signature in blue ink, appearing to read "Michael Nicholas". The signature is fluid and cursive, with the first name "Michael" being more prominent than the last name "Nicholas".

Michael Nicholas
CEO



December 13, 2011

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street
Alexandria, VA 22314

**Re: MSRB Notice 2011-63 (November 8, 2011): Request for
Comment on Restated Sophisticated Municipal Market
Professional Notice**

Dear Mr. Smith:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates the opportunity to comment on the Municipal Securities Rulemaking Board’s (“MSRB”) Request for Comment on Restated Sophisticated Municipal Market Professional Notice (the “Proposal”).

I. Executive Summary

SIFMA commends the MSRB for proposing a revised and expanded definition of Sophisticated Municipal Market Professional (“SMMP”) as the quality and availability of information concerning municipal securities has greatly improved since 2002². SIFMA has long championed creating a class of sophisticated investors, such as SMMP investors, which has led to the development of online trading platforms and improved liquidity and transparency in the municipal market. Additionally, SIFMA agrees with the MSRB that having special rules for such a class of sophisticated investors is “desirable from the standpoint of reducing the cost of dealer compliance to maintain consistency with [Financial Industry Regulatory Authority] rules, absent clear reasons for treating

¹ SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

² Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals (April 30, 2002).

Mr. Ronald W. Smith
Municipal Securities Rulemaking Board
Page 2 of 5

transactions in municipal securities differently.”³ Accordingly, we suggest several ways in which the SMMP standard could be made even better. To the greatest extent possible, the SMMP standard should be harmonized with Financial Industry Regulatory Authority (“FINRA”) Rule 2111 as it applies to institutional customers. SIFMA feels that all institutional accounts under FINRA’s jurisdiction should be treated the same way: there is no reason why both qualifications and compliance obligations can’t be the same under both rules. In the alternative, the proposed “safe harbor”, while welcomed, is too narrowly defined in two respects and should be broadened. First, the requisite assets required to be held or have under management should not be limited to municipal securities. Additionally, a presumption should exist that certain types of institutional customers are capable of evaluating, baring knowledge of a material change in the investor’s circumstances, the investment risk and market value of the municipal securities at issue – thereby obviating the need for dealers to obtain an attestation from them to these elements.

II. Revised Definition of SMMP

SIFMA supports the proposed revised definition of SMMP so that it is harmonized with FINRA’s revised suitability rule as it applies to institutional customers. Accordingly, dealers will be able to treat as an SMMP an institutional customer⁴that: (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 attests that it is exercising independent judgment in evaluating the recommendations of the dealer. Individuals, corporations, partnerships and trusts with total assets of at least \$50 million may qualify to be an SMMP.

III. Harmonization with FINRA Rule 2111

SIFMA supports the revised definition of SMMP so that it is consistent with FINRA Rule 2111’s suitability obligations for institutional accounts. It appears based upon FINRA Rule 2111 that no product specific product

³ MSRB NOTICE 2011-63.

⁴ “Institutional customer” is defined as a customer with an institutional account (as defined under MSRB Rule G-8(a)(xi)). MSRB 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.”

Mr. Ronald W. Smith
Municipal Securities Rulemaking Board
Page 3 of 5

specialization is required to satisfy this definition. SIFMA's members are concerned with the requirement that the proposed SMMP safe harbor contains a product specific investment requirement which could lead to significant confusion among institutional customers due to the varied standards. Additionally, investing in municipal securities generally suggests an appetite for lower credit risk tolerance than other securities as the default rates for municipal securities are generally significantly lower than in other debt asset classes. Continuing with an SMMP standard that is more stringent than FINRA Rule 2111, where institutional customers can invest in products with greater risks, but no product specific experience, is contradictory. Further, there should be a harmonized compliance regime to allow an institutional customer to complete a single affirmation to satisfy FINRA Rule 2111 for all products, including the MSRB's requirements for SMMP status.

IV. Unique SMMP Requirements

Should the MSRB choose not to harmonize the Proposal with FINRA Rule 2111, we suggest the following as an alternative:

A. Safe Harbor

As detailed in the Proposal, the MSRB has proposed there be a safe harbor which will allow a dealer to satisfy the "reasonable basis" requirement of clause (1) of the SMMP definition, if: (i) the institutional customer has total assets of at least \$50 million invested in municipal securities in the aggregate in its portfolio and/or under management, and (ii) the institutional customer attests that it is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions in municipal securities. While a safe harbor is always welcome, this proposed safe harbor is too narrow to be useful in two respects: the specific asset class limitation needed to satisfy the \$50 million threshold; and requiring an attestation from all institutional customers.

i. Assets to Qualify for Safe Harbor

One component of the proposed safe harbor would require that the institutional customer have total assets of at least \$50 million invested in municipal securities in the aggregate in its portfolio and/or under management. We feel the \$50 million threshold is unnecessarily high if the MSRB proceeds with a product specific investment requirement to qualify for the safe harbor, unlike FINRA Rule 2111 which only has portfolio level requirements, we believe this dollar threshold should be reduced to \$25 million. Having assets of at least \$25 million in municipal securities demonstrates a customer's: 1) high level of general level of experience in municipal securities markets; 2) ability to understand the economic features of a municipal security; and 3) ability to independently evaluate how market developments would affect municipal

Mr. Ronald W. Smith
Municipal Securities Rulemaking Board
Page 4 of 5

securities. Additionally, this would allow institutional customer “crossover” buyers having a substantial investment in municipal securities (i.e. \$25 million) as well as \$25 million invested in other assets classes to be afforded the safe harbor.

ii. Customer Attestation

Under FINRA Rule 2111, the exemption from determining security-specific suitability for such institutional investors permits dealers to receive an affirmation (not an attestation) of each such customer’s desire to exercise independent judgment in selecting investments when transacting in FINRA regulated securities. To suggest a different affirmation by SMMPs under the MSRB rules, with differing terms and subtle distinctions, will be a costly exercise for our industry and its sophisticated buy-side clients with little incremental benefit. We believe that the affirmation by an institutional investor of its desire to exercise independent judgment, coupled with a more realistic threshold for municipal assets or assets under management, will more than adequately protect such investors while ensuring that they are sophisticated with regard to municipal securities. A municipal dealer that has checked a client’s status as an institutional investor and determined that the client holds or manages an adequate amount of municipal securities should be afforded a presumption that it has fulfilled its regulatory duties in classifying such customer as an SMMP under the rules for the municipal securities market.

SIFMA supports the need for certain institutional customers to provide an affirmation that they are capable of evaluating investment risk and market value of the securities at issue. However, SIFMA does not support having the following institutional customers provide such an affirmation to qualify for the safe harbor: 1) banks, savings and loan associations, insurance companies, or registered investment companies; and 2) investment advisers 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). These categories of institutional investors are already recognized by other market regulators as being sophisticated participants in the financial markets capable of assessing the risks and benefits of investments, and are subject to significant capital adequacy, assets, or assets-under-management thresholds as defined under their relevant regulatory schemes.

B. Non-Safe Harbor SMMPs

We also believe that certain institutional investors who are new entrants to the market for municipal securities (for instance, a bond mutual fund manager seeking taxable municipals to distribute credit risk) should also be afforded SMMP status. An institutional customer having total assets of at least \$50 million (with no minimum amount of municipal securities) could still qualify as an SMMP if (1) the dealer has a reasonable basis to believe the customer is capable

Mr. Ronald W. Smith
Municipal Securities Rulemaking Board
Page 5 of 5

of evaluating municipal investment risks and municipal market values independently, both in general and with regard to particular transactions in municipal securities, and (2) the customer affirms that it is exercising independent judgment in evaluating the recommendations of the dealer. SIFMA supports these elements of the Proposal, but believes that an affirmation made by an institutional customer under FINRA Rule 2111 should be sufficient and result in greater compliance efficiencies. Requiring an additional SMMP affirmation is not warranted. As mentioned above, having a separate affirmation by SMMPs, with differing terms and subtle distinctions, will be a costly exercise for our industry and its sophisticated buy-side clients with little incremental benefit.

V. Conclusion

SIFMA sincerely appreciates this opportunity to comment upon the Proposal. SIFMA commends the MSRB for proposing a revised and expanded definition of SMMP and has suggested, above, several ways in which we believe the SMMP standard could be made even better which would result in additional developments in the online market and improving liquidity throughout the municipal market. To the greatest extent possible, the SMMP standard should be harmonized with the institutional customer exemption contained in FINRA Rule 2111, absent clear reasons for treating transactions in municipal securities differently.

Please do not hesitate to contact me with any questions at (212) 313-1265. SIFMA welcomes the opportunity to discuss all aspects of this Proposal with the MSRB.

Sincerely yours,



David L. Cohen
Managing Director
Associate General Counsel

cc:

Municipal Securities Rulemaking Board

Lynnette Kelly Hotchkiss, Executive Director

Ernesto Lanza, Deputy Executive Director and General Counsel

Peg Henry, General Counsel, Market Regulation



December 13, 2011

Ms. Peg Henry, General Counsel, Market Regulation
Municipal Securities Rulemaking Board
1600 Duke St.
Suite 600
Alexandria, Virginia 22314

Dear Ms. Henry:

TMC Bonds L.L.C. (“TMC”), formerly, TheMuniCenter, welcomes the opportunity to comment on the Municipal Securities Rulemaking Board’s (“MSRB’s”) proposed changes to the 2002 notice with respect to “sophisticated municipal market professionals” (“SMMPs”). TMC Bonds is an electronic marketplace that has been using the existing SMMP notice as the primary guideline for evaluating institutional accounts in the municipal application. We thoroughly agree with the notion that, in the intervening decade since the original release of the notice, the market has developed to the extent that participants have vastly expanded access to information on market structure and behavior, up-to-date information on material and credit events, and access to trading history on individual securities, much of this courtesy of the MSRB’s efforts. Also, we find it appropriate that the Board has chosen to simplify the definition of SMMP and to conform the definitions to FINRA Rule 2111.

TMC’s most substantive comment on the proposed revisions pertains to the \$50mm-in-municipal-assets component of the proposed safe harbor. Our belief is that ownership of municipals is not a prerequisite to being an SMMP. There are myriad institutional accounts that, from time to time, choose to invest in municipals for relative value reasons, even though such accounts do not hold tax-exempt securities as a core asset. An extreme example would be that of a hedge fund with billions of dollars in assets in taxable fixed income securities, that decides that a large relative value trade in municipals makes sense for the fund. In such a case, this fund would not be in the safe harbor as the proposed notice defines it, even though the investor clearly would be “sophisticated” and capable of evaluating the risks and potential benefits of the trade. As a result, we feel that the asset test, with respect to the safe harbor, should simply be \$50mm in direct fixed income assets, not necessarily \$50mm in municipals.

As indicated, we agree with the Board's effort to align the definition of SMMP with FINRA Rule 2111. Our only observation here is to encourage the Board to make the attestation process, whereby the client asserts that it is an SMMP, flexible and easy to administer. Also, it would be helpful if the Board clarified whether dealers need to get attestation from existing clients, who have already been vetted as SMMPs under the 2002 release, given that any existing SMMP client would almost certainly qualify under the new notice.

Many thanks for the opportunity to respond.

Sincerely,

John S. Craft
Director of Sales & Marketing
TMC Bonds L.L.C.

EXHIBIT 5

Note: Proposed new language is underlined. Proposed deletions are enclosed in brackets.

RESTATED INTERPRETIVE NOTICE REGARDING THE APPLICATION OF MSRB RULES TO TRANSACTIONS WITH SOPHISTICATED MUNICIPAL MARKET PROFESSIONALS [- April 30, 2002]

[Industry participants have suggested that the] **The** MSRB's fair practice rules [should] allow dealers[1] 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] **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.

[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] **affect** how such quotation is treated under [rule] **Rule** G-13.

[Considerations Regarding The Identification Of Sophisticated Municipal Market Professionals]

Application of SMMP Concept to Rule G-17

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.] **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]**

[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®) system[3] 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] **However, 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] **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] **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 **a** par with inter-dealer disclosure obligations. This interpretation will be particularly relevant to dealers operating [electronic trading platforms] **alternative trading systems**, although it will also apply to **other** 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] **when** the information is not accessible through established industry sources, may constitute an unfair practice [violative of rule] **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 [Interpretation—Duty to Ensure That Agency Transactions Are Effected at Fair and Reasonable Prices]

Rule G-18 [requires] **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. [[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] **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] **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] **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] **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 [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] **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] **Rule** G-19 to have a "reasonable basis" to believe that the recommendation could be suitable for at least some customers. [[10]] **[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] **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] **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 [is presumed to be a quotation made by such dealer. In addition, any “quotation” of a non-dealer (e.g.,] **(including the quotation of 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] the dealer [.]**[11] The **and the** dealer is [affirmatively] responsible [in either case] for ensuring compliance with the *bona fide* and fair market value requirements with respect to [such] **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. [Furthermore, if] **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. [[12]] **[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] **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]] **[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. [[14]] **[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 20, 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).

[[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*, Exchange Act Release No. 26100 (September 22, 1988) (the "1988 SEC Release") at text accompanying note 72.]

[5] See MSRB Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts (March 20, 2002); see also MSRB Notice Regarding Application of Rule G-19, on Suitability of Recommendations and Transactions, to Online Communications (September 25, 2002).

[[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.]

[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.

[[12]] **[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.

[[13]] **[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] **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.] **MSRB Rule G-21 Interpretive Letter – Disclosure Obligations (May 21, 1998)**.

[[14]] **[9]** 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.] **MSRB Notice of Interpretation of Rule G-13 on Published Quotations (April 21, 1988)**.