Accessed from http://www.msrb.org. ©2020 Municipal Securities Rulemaking Board. All rights reserved.
MSRB is a registered trademark of the Municipal Securities Rulemaking Board.
Reprinted with permission of MSRB. Version date October 1, 2019.

of a dealer's obligation to deal fairly, the MSRB has interpreted the rule to create affirmative disclosure obligations for dealers. The MSRB has stated that the dealer's affirmative disclosure obligations require that a dealer disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security.[2] These obligations apply even when a dealer is effecting non-recommended secondary market transactions.

In the context of the sale to customers of an original issue discount security, the MSRB's customer confirmation rule, Rule G-15(a), provides that information regarding the status of bonds as original issue discount securities must be included on customer confirmations. Specifically, Rule G-15(a)(i)(C)(4)(c) provides that, "If the securities pay periodic interest and are sold by the underwriter as original issue discount securities, a designation that they are "original issue discount" securities and a statement of the initial public offering price of the securities, expressed as a dollar price" must be included on the customer's confirmation.

The MSRB previously has alerted dealers of their obligation to make original issue discount disclosures to customers and has stated that, "The Board believes that the fact that a security bears an original issue discount is material information (since it may affect the tax treatment of the security); therefore, this fact should be disclosed to a customer prior to or at the time of trade."[3] The MSRB is publishing this notice to remind dealers of their disclosure obligations under Rule G-17 because it remains concerned that, absent adequate disclosure of a security's original issue discount status, an investor might not be aware that all or a portion of the component of his or her investment return represented by accretion of the discount is tax-exempt, and therefore might sell the securities at an inappropriately low price (*i.e.*, at a price not reflecting the tax-exempt portion of the discount) or pay capital gains tax on the accreted discount amount. Without appropriate disclosure, an investor also might not be aware of how his or her transaction price compares to the initial public offering price of the security. Appropriate disclosure of a security's original issue discount feature should assist customers in computing the market discount or premium on their transaction.

[1] *See* Glossary of Municipal Securities Terms, Second Edition (January 2004).

[2] *See e.g.*, Rule G-17 Interpretation — Educational Notice on Bonds Subject to "Detachable" Call Features, May 13, 1993, MSRB Rule Book (July 2004) at 135.

[3] Rules G-12 and G-15, Comments Requested on Draft Amendments on Original Issue Discount Securities, *MSRB Reports*, Vol. 4, No. 6 (May 1994) at 7.

Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans

August 7, 2006

The Municipal Securities Rulemaking Board ("MSRB") is publishing this interpretation to ensure that brokers, dealers and municipal securities dealers ("dealers") effecting transactions in the 529 college savings plan market fully understand their fair practice and disclosure duties to their customers.[1]

Basic Customer Protection Obligation

At the core of the MSRB's customer protection rules is Rule G-17, which provides that, in the conduct of its municipal securities activities, each dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice. The rule encompasses two basic principles: an anti-fraud prohibition similar to the standard set forth in Rule 10b-5 adopted by the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934 (the "Exchange Act"), and a general duty to deal fairly even in the absence of fraud. All activities of dealers must be viewed in light of these basic principles, regardless of whether other MSRB rules establish specific requirements applicable to such activities.

Disclosure

The MSRB has interpreted Rule G-17 to require a dealer, in connection with any transaction in municipal securities, to disclose to its customer, at or prior to the sale of the securities to the customer (the "time of trade"), all material facts about the transaction known by the dealer, as well as material facts about the security that are reasonably accessible to the market.[2] This duty applies to any dealer transaction in a 529 college savings plan interest regardless of whether the transaction has been recommended by the dealer.

Many states offer favorable state tax treatment or other valuable benefits to their residents in connection with investments in their own 529 college savings plan. In the case of sales of out-of-state 529 college savings plan interests to a customer, the MSRB views Rule G-17 as requiring a dealer to make, at or prior to the time of trade, additional disclosures that:

(i) depending upon the laws of the home state of the customer or designated beneficiary, favorable state tax treatment or other benefits offered by such home state for investing in 529 college savings plans may be available only if the customer invests in the home state's 529 college savings plan;

(ii) any state-based benefit offered with respect to a particular 529 college savings plan should be one of many appropriately weighted factors to be considered in making an investment decision; and

(iii) the customer should consult with his or her financial, tax or other adviser to learn more about how state-based benefits (including any limitations) would apply to the customer's specific circumstances and also may wish to contact his or her home state or any other 529 college savings plan to learn more about the features, benefits and limitations of that state's 529 college savings plan.

Accessed from http://www.msrb.org. ©2020 Municipal Securities Rulemaking Board. All rights reserved.
MSRB is a registered trademark of the Municipal Securities Rulemaking Board.
Reprinted with permission of MSRB. Version date October 1, 2019.

This disclosure obligation is hereinafter referred to as the "out-of-state disclosure obligation."[3]

The out-of-state disclosure obligation may be met if the disclosure appears in the program disclosure document, so long as the program disclosure document has been delivered to the customer at or prior to the time of trade and the disclosure appears in the program disclosure document in a manner that is reasonably likely to be noted by an investor.[4] A presentation of this disclosure in the program disclosure document in close proximity and with equal prominence to the principal presentation of substantive information regarding other federal or state tax-related consequences of investing in the 529 college savings plan, and the inclusion of a reference to this disclosure in close proximity and with equal prominence to each other presentation of information regarding state tax-related consequences of investing in the 529 college savings plan, would be deemed to satisfy this requirement.[5]

The MSRB has no authority to mandate inclusion of any particular items in the issuer's program disclosure document.[6] Dealers who wish to rely on the program disclosure document for fulfillment of the out-of-state disclosure obligation are responsible for understanding what is included within the program disclosure document of any 529 college savings plan they market and for determining whether such information is sufficient to meet this disclosure obligation. Notwithstanding any of the foregoing, disclosure through the program disclosure document as described above is not the sole manner in which a dealer may fulfill its out-of-state disclosure obligation. Thus, if the issuer has not included this information in the program disclosure document in the manner described, inclusion in the program disclosure document in another manner may nonetheless fulfill the dealer's out-of-state disclosure obligation so long as disclosure in such other manner is reasonably likely to be noted by an investor. Otherwise, the dealer would remain obligated to disclose such information separately to the customer under Rule G-17 by no later than the time of trade.[7]

If the dealer proceeds to provide information to an out-of-state customer about the state tax or other benefits available through such customer's home state, Rule G-17 requires that the dealer ensure that the information is not false or misleading. For example, a dealer would violate Rule G-17 if it were to inform a customer that investment in the 529 college savings plan of the customer's home state did not provide the customer with any state tax benefit even though such a state tax benefit is in fact available. Furthermore, a dealer would violate Rule G-17 if it were to inform a customer that investment in the 529 college savings plan of another state would provide the customer with the same state tax benefits as would be available if the customer were to invest in his or her home state's 529 college savings plan even though this is not the case.[8] Dealers should make certain that information they provide to their customers, whether provided under an affirmative disclosure obligation imposed by MSRB rules or in response to questions from customers, is correct and not misleading.

Dealers are reminded that this out-of-state disclosure obligation is in addition to their general obligation under Rule G-17 to disclose to their customers at or prior to the time of trade all material facts known by dealers about the 529 college savings plan interests they are selling to their customers, as well as material facts about such 529 college savings plan that are reasonably accessible to the market. Further, dealers are reminded that disclosures made to customers as required under MSRB rules with respect to 529 college savings plans do not relieve dealers of their suitability obligations — including the obligation to consider the customer's financial status, tax status and investment objectives — if they have recommended investments in 529 college savings plans.

Suitability

Under Rule G-19, a dealer that recommends to a customer a transaction in a security must have reasonable grounds for believing that the recommendation is suitable, based upon information available from the issuer of the security or otherwise and the facts disclosed by or otherwise known about the customer.[9] To assure that a dealer effecting a recommended transaction with a non-institutional customer has the information needed about the customer to make its suitability determination, the rule requires the dealer to make reasonable efforts to obtain information concerning the customer's financial status, tax status and investment objectives, as well as any other information reasonable and necessary in making the recommendation.[10] Dealers are reminded that the obligation arising under Rule G-19 in connection with a recommended transaction requires a meaningful analysis, taking into consideration the information obtained about the customer and the security, that establishes the reasonable grounds for believing that the recommendation is suitable. Such suitability determinations should be based on the appropriately weighted factors that are relevant in any particular set of facts and circumstances, which factors may vary from transaction to transaction.[11] Pursuant to Rule G-27(c), dealers must have written supervisory procedures in place that are reasonably designed to ensure compliance with this Rule G-19 obligation to undertake a suitability analysis in connection with every recommended transaction, and dealers must enforce these procedures to ensure that such meaningful analysis does in fact occur in connection with the dealer's recommended transactions.

In the context of a recommended transaction relating to a 529 college savings plan, the MSRB believes that it is crucial for dealers to remain cognizant of the fact that these instruments are designed for a particular purpose and that this purpose generally should match the customer's investment objective. For example, dealers should bear in mind the potential tax consequences of a customer making an investment in a 529 college savings plan where the dealer understands that the customer's investment objective may not involve use of such funds for qualified higher education expenses.[12] Dealers also should consider whether a recommendation is consistent with

Accessed from http://www.msrb.org. ©2020 Municipal Securities Rulemaking Board. All rights reserved.
MSRB is a registered trademark of the Municipal Securities Rulemaking Board.
Reprinted with permission of MSRB. Version date October 1, 2019.

the customer's tax status and any customer investment objectives materially related to federal or state tax consequences of an investment.

Furthermore, investors generally are required to designate a specific beneficiary under a 529 college savings plan. The MSRB believes that information known about the designated beneficiary generally would be relevant in weighing the investment objectives of the customer, including (among other things) information regarding the age of the beneficiary and the number of years until funds will be needed to pay qualified higher education expenses of the beneficiary. The MSRB notes that, since the person making the investment in a 529 college savings plan retains significant control over the investment (*e.g.*, may withdraw funds, change plans, or change beneficiary, etc.), this person is appropriately considered the customer for purposes of Rule G-19 and other MSRB rules. As noted above, information regarding the designated beneficiary should be treated as information relating to the customer's investment objective for purposes of Rule G-19.

In many cases, dealers may offer the same investment option in a 529 college savings plan sold with different commission structures. For example, an A share may have a front-end load, a B share may have a contingent deferred sales charge or back-end load that reduces in amount depending upon the number of years that the investment is held, and a C share may have an annual asset-based charge. A customer's investment objective — particularly, the number of years until withdrawals are expected to be made — can be a significant factor in determining which share class would be suitable for the particular customer.

Rule G-19(e), on churning, prohibits a dealer from recommending transactions to a customer that are excessive in size or frequency, in view of information known to such dealer concerning the customer's financial background, tax status and investment objectives. Thus, for example, where the dealer knows that a customer is investing in a 529 college savings plan with the intention of receiving the available federal tax benefit, such dealer could, depending upon the facts and circumstances, violate rule G-19(e) if it were to recommend roll-overs from one 529 college savings plan to another with such frequency as to lose the federal tax benefit. Even where the frequency does not imperil the federal tax benefit, roll-overs recommended year after year by a dealer could, depending upon the facts and circumstances (including consideration of legitimate investment and other purposes), be viewed as churning. Similarly, depending upon the facts and circumstances, where a dealer recommends investments in one or more plans for a single beneficiary in amounts that far exceed the amount that could reasonably be used by such beneficiary to pay for qualified higher education expenses, a violation of rule G-19(e) could result.[13]

Other Sales Practice Principles

Dealers must keep in mind the requirements under Rule G-17 — that they deal fairly with all persons and that they not engage in any deceptive, dishonest or unfair practice — when considering the appropriateness of day-to-day sales-related activities with respect to municipal fund securities, including 529 college savings plans. In some cases, certain sales-related activities are governed in part by specific MSRB rules, such as Rule G-19 (as described above) and Rule G-30(b), on commissions.[14] Other activities may not be explicitly addressed by a specific MSRB rule. In either case, the general principles of Rule G-17 always apply.

In particular, dealers must ensure that they do not engage in transactions primarily designed to increase commission revenues in a manner that is unfair to customers under Rule G-17. Thus, in addition to being a potential violation of Rule G-19 as discussed above, recommending a particular share class to a customer that is not suitable for that customer, or engaging in churning, may also constitute a violation of Rule G-17 if the recommendation was made for the purpose of generating higher commission revenues. Also, where a dealer offers investments in multiple 529 college savings plans, consistently recommending that customers invest in the one 529 college savings plan that offers the dealer the highest compensation may, depending on the facts and circumstances, constitute a violation of Rule G-17 if the recommendation of such 529 college savings plan over the other 529 college savings plans offered by the dealer does not reflect a legitimate investment-based purpose.

Further, recommending transactions to customers in amounts designed to avoid commission discounts (*i.e.*, sales below breakpoints where the customer would be entitled to lower commission charges) may also violate Rule G-17, depending upon the facts and circumstances. For example, a recommendation that a customer make two smaller investments in separate but nearly identical 529 college savings plans for the purposes of avoiding a reduced commission rate that would be available upon investing the full amount in a single 529 college savings plan, or that a customer time his or her multiple investments in a 529 college savings plan so as to avoid being able to take advantage of a lower commission rate, in either case without a legitimate investment-based purpose, could violate Rule G-17.

With respect to sales incentives, the MSRB has previously interpreted Rule G-20, relating to gifts, gratuities and non-cash compensation, to require a dealer that sponsors a sales contest involving representatives who are not employed by the sponsoring dealer to have in place written agreements with these representatives.[15] In addition, the general principles of Rule G-17 are applicable. Thus, if a dealer or any of its associated persons engages in any marketing activities that result in a customer being treated unfairly, or if the dealer or any of its associated persons engages in any deceptive, dishonest or unfair practice in connection with such marketing activities, Rule G-17 could be violated. The MSRB believes that,

Accessed from http://www.msrb.org. ©2020 Municipal Securities Rulemaking Board. All rights reserved.
MSRB is a registered trademark of the Municipal Securities Rulemaking Board.
Reprinted with permission of MSRB. Version date October 1, 2019.

depending upon the specific facts and circumstances, a dealer may violate Rule G-17 if it acts in a manner that is reasonably likely to induce another dealer or such other dealer's associated persons to violate the principles of Rule G-17 or other MSRB customer protection rules, such as Rule G-19 or Rule G-30. Dealers are also reminded that Rule G-20 establishes standards regarding incentives for sales of municipal securities, including 529 college savings plan interests, that are substantially similar to those currently applicable to sales of mutual fund shares under NASD rules.

---

[1] 529 college savings plans are established by states under Section 529(b)(A)(ii) of the Internal Revenue Code as "qualified tuition programs" through which individuals make investments for the purpose of accumulating savings for qualifying higher education costs of beneficiaries. Section 529 of the Internal Revenue Code also permits the establishment of so-called prepaid tuition plans by states and higher education institutions, which are not treated as 529 college savings plans for purposes of this notice.

[2] *See* Rule G-17 Interpretation — Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, reprinted in *MSRB Rule Book*.

[3] This out-of-state disclosure obligation constitutes an expansion of, and supersedes, certain disclosure requirements with respect to out-of-state 529 college savings plan transactions established under "Application of Fair Practice and Advertising Rules to Municipal Securities," May 14, 2002, published in *MSRB Rule Book*.

[4] As used in this notice, the term "program disclosure document" has the same meaning as "official statement" under the rules of the MSRB and SEC. The delivery of the program disclosure document to customers pursuant to Rule G-32, which requires delivery by settlement of the transaction, would be timely for purposes of Rule G-17 only if such delivery is accelerated so that it is received by the customer by no later than the time of trade.

[5] Thus, if the program disclosure document contains a series of sections in which the principal disclosures of substantive information on federal or state-tax related consequences of investing in the 529 college savings plan appear, a single inclusion of the required disclosure within, at the beginning or at the end of such series would be satisfactory for purposes of the inclusion with the principal presentation of such other disclosures. Similarly, if the program disclosure document includes any other series of statements on state-tax related consequences, such as might exist in a summary statement appearing at the beginning of some program disclosure documents, a single prominent reference in the summary statement to the fuller disclosure made pursuant to the out-of-state disclosure obligation appearing elsewhere in the program disclosure document would be satisfactory.

[6] However, the MSRB notes that Exchange Act Rule 15c2-12(f)(3) of the SEC defines a "final official statement" as:

> a document or set of documents prepared by an issuer of municipal securities or its representatives that is complete as of the date delivered to the Participating Underwriter(s) and that sets forth information concerning the terms of the proposed issue of securities; information, including financial information or operating data, concerning such issuers of municipal securities and those other entities, enterprises, funds, accounts, and other persons material to an evaluation of the Offering; and a description of the undertakings to be provided pursuant to paragraph (b)(5)(i), paragraph (d)(2)(ii), and paragraph (d)(2)(iii) of this section, if applicable, and of any instances in the previous five years in which each person specified pursuant to paragraph (b)(5)(ii) of this section failed to comply, in all material respects, with any previous undertakings in a written contract or agreement specified in paragraph (b)(5)(i) of this section.

Section (b) of that rule requires that the participating underwriter of an offering review a "deemed-final" official statement and contract to receive the final official statement from the issuer. *See* Rule D-12 Interpretation — Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market, January 18, 2001, published in *MSRB Rule Book*, for a discussion of the applicability of Rule 15c2-12 to offerings of 529 college savings plans.

[7] Although Rule G-17 does not dictate the precise manner in which material facts must be disclosed to the customer at or prior to the time of trade, dealers must ensure that such disclosure is effectively provided to the customer in connection with the specific transaction and cannot merely rely on the inclusion of a disclosure in general advertising materials.

[8] Dealers should note that these examples are illustrative and do not limit the circumstances under which, depending on the facts and circumstances, a Rule G-17 violation could occur.

[9] The MSRB has previously stated that most situations in which a dealer brings a municipal security to the attention of a customer involve an implicit recommendation of the security to the customer, but determining whether a particular transaction is in fact recommended depends on an analysis of all the relevant facts and circumstances. *See* Rule G-19 Interpretive Letter — Recommendations, February 17, 1998, published in *MSRB Rule Book*. The MSRB also has provided guidance on recommendations in the context of on-line communications in Rule G-19 Interpretation — Notice Regarding Application of Rule G-19, on Suitability of Recommendations and Transactions, to Online Communications, September 25, 2002, published in *MSRB Rule Book*.

[10] Rule G-8(a)(xi)(F) requires that dealers maintain records for each customer of such information about the customer used in making recommendations to the customer.

[11] Although certain factors relating to recommended transactions in 529 college savings plans are discussed in this notice, whether such enumerated factors or any other considerations are relevant in connection with a particular recommendation is dependent upon the facts and circumstances. The factors that may be relevant with respect to a specific transaction in a 529 college savings plan generally include the various considerations that would be applicable in connection with the process of making suitability determinations for recommendations of any other type of security.

[12] See Section 529(c)(3) of the Internal Revenue Code. State tax laws also may result in certain adverse consequences for use of funds other than for educational costs.

[13] The MSRB understands that investors may change designated beneficiaries and therefore amounts in excess of what a single beneficiary could use ultimately might be fully expended by additional beneficiaries. The MSRB expresses no view as to the applicability of federal tax law to any particular plan of investment and does not interpret its rules to prohibit transactions in furtherance of legitimate tax planning objectives, so long as any recommended transaction is suitable.

[14] The MSRB has previously provided guidance on dealer commissions in Rule G-30 Interpretation — Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001, published in *MSRB Rule Book*. The MSRB believes that Rule G-30(b), as interpreted in this 2001 guidance, should effectively maintain dealer charges for 529 college savings plan sales at a level consistent with, if not lower than, the sales loads and commissions charged for comparable mutual fund sales.

[15] *See* Rule G-20 Interpretive Letter —Authorization of sales contests, June 25, 1982, published in *MSRB Rule Book*.

Reminder of Customer Protection Obligations in Connection with Sales of Municipal Securities

March 30, 2007

The Municipal Securities Rulemaking Board ("MSRB") is publishing this notice to remind brokers, dealers and municipal securities dealers ("dealers") of their customer protection obligations — specifically the application of Rule G-17, on fair

Accessed from http://www.msrb.org. ©2020 Municipal Securities Rulemaking Board. All rights reserved.
MSRB is a registered trademark of the Municipal Securities Rulemaking Board.
Reprinted with permission of MSRB. Version date October 1, 2019.

dealing, and Rule G-19, on suitability — in connection with their municipal securities sales activities, including but not limited to situations in which dealers offer sales incentives.[1]

Basic Customer Protection Obligation

At the core of the MSRB's customer protection rules is Rule G-17 which provides that, in the conduct of its municipal securities activities, each dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice. The rule encompasses two basic principles: an anti-fraud prohibition similar to the standard set forth in Rule 10b-5 adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, and a general duty to deal fairly even in the absence of fraud. All activities of dealers must be viewed in light of these basic principles, regardless of whether other MSRB rules establish specific requirements applicable to such activities.

Disclosure

The MSRB has interpreted Rule G-17 to require a dealer, in connection with any transaction in municipal securities, to disclose to its customer, at or prior to the sale of the securities to the customer, all material facts about the transaction known by the dealer, as well as material facts about the security that are reasonably accessible to the market.[2] This duty applies to any transaction in a municipal security regardless of whether the dealer has recommended the transaction. Dealers should make certain that information they provide to their customers, whether provided under an affirmative disclosure obligation imposed by MSRB rules or in response to questions from customers, is correct and not misleading. Further, dealers are reminded that disclosures made to customers as required under MSRB rules do not relieve dealers of their suitability obligations — including the obligation to consider the customer's financial status, tax status and investment objectives — if they have recommended transactions in municipal securities.

Suitability

Under Rule G-19, a dealer that recommends to a customer a transaction in a municipal security must have reasonable grounds for believing that the recommendation is suitable, based upon information available from the issuer of the security or otherwise and the facts disclosed by or otherwise known about the customer.[3] To assure that a dealer effecting a recommended transaction with a non-institutional customer has the information needed about the customer to make its suitability determination, Rule G-19 requires the dealer to make reasonable efforts to obtain information concerning the customer's financial status, tax status and investment objectives, as well as any other information reasonable and necessary in making the recommendation.[4] Dealers are reminded that the obligation arising under Rule G-19 in connection with a recommended transaction requires a meaningful analysis, taking into consideration the information obtained about the customer and the security, which establishes the reasonable grounds for believing that the recommendation is suitable. Such suitability determinations should be based on the appropriately weighted factors that are relevant in any particular set of facts and circumstances, which factors may vary from transaction to transaction. Pursuant to Rule G-27, on supervision, dealers must have written supervisory procedures in place that are reasonably designed to ensure compliance with the Rule G-19 obligation to undertake a suitability analysis in connection with every recommended transaction, and dealers must enforce these procedures to ensure that such meaningful analysis does in fact occur in connection with the dealer's recommended transactions.

Other Sales Practice Principles

Dealers must keep in mind the requirements under Rule G-17 — that they deal fairly with all persons and that they not engage in any deceptive, dishonest or unfair practice — when considering the appropriateness of day-to-day sales-related activities with respect to municipal securities. In some cases, certain sales-related activities are governed in part by specific MSRB rules, such as Rule G-19 (as described above), Rule G-18 on execution of transactions, and Rule G-30 on prices and commissions. Other activities may not be explicitly addressed by a specific MSRB rule. In either case, the general principles of Rule G-17 always apply.

In particular, dealers must ensure that they do not engage in transactions that are unfair to customers under Rule G-17. This principle applies in the case of an individual transaction to ensure that the dealer does not unfairly attempt to increase its own revenue or otherwise advance its interests without due regard to the customer's interests. In addition, where a dealer consistently recommends that customers invest in the municipal securities that offer the dealer the highest compensation, such pattern or general practice may, depending on the facts and circumstances, constitute a violation of Rule G-17 if the recommendation of such municipal securities over the other municipal securities offered by the dealer does not reflect a legitimate investment-based purpose.

With respect to sales incentives, the MSRB has previously interpreted Rule G-20, relating to gifts, gratuities and non-cash compensation, to require a dealer that sponsors a sales contest involving representatives who are not employed by the sponsoring dealer to have in place written agreements with these representatives.[5] Dealers are also reminded that Rule G-20(d) establishes standards regarding non-cash incentives for sales of municipal securities that are substantially similar to those currently applicable to the public offering of corporate securities under NASD Rule 2710(i) but also include "total production" and "equal weighting" requirements for internal sales contests. Dealers should be mindful that financial incentives may cause an associated person (whether an associated person of the dealer offering the sales incentive or an associated person of another dealer) to favor one municipal security over another and thereby potentially compromise the dealer's obligations under MSRB rules, including Rules G-17 and G-19. Rule G-17 may be violated if a dealer or any of its asso-

Accessed from http://www.msrb.org. ©2020 Municipal Securities Rulemaking Board. All rights reserved.
MSRB is a registered trademark of the Municipal Securities Rulemaking Board.
Reprinted with permission of MSRB. Version date October 1, 2019.

ciated persons engages in any marketing activities that result in a customer being treated unfairly, or if the dealer or any of its associated persons engages in any deceptive, dishonest or unfair practice in connection with such marketing activities. The MSRB also believes that, depending upon the specific facts and circumstances, a dealer may violate Rule G-17 if it acts in a manner that is reasonably likely to induce another dealer or such other dealer's associated persons to violate the principles of Rule G-17 or other MSRB customer protection rules, such as Rule G-18, G-19 or Rule G-30.

---

[1] The principles enunciated in this notice were previously discussed, in the context of the 529 college savings plan market, in *Rule G-17 Interpretation — Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans* (August 7, 2006), reprinted in *MSRB Rule Book*. This notice makes clear that the general principles discussed in the August 2006 interpretation also apply in the context of the markets for municipal bonds, notes and other types of municipal securities. This notice in no way alters the substance or applicability of the August 2006 interpretation with respect to the 529 college savings plan market.

[2] *See Rule G-17 Interpretation — Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts* (March 20, 2002), reprinted in *MSRB Rule Book*.

[3] The MSRB has previously stated that most situations in which a dealer brings a municipal security to the attention of a customer involve an implicit recommendation of the security to the customer, but determining whether a particular transaction is in fact recommended depends on an analysis of all the relevant facts and circumstances. *See Rule G-19 Interpretive Letter — Recommendations*, February 17, 1998, reprinted in *MSRB Rule Book*. The MSRB also has provided guidance on recommendations in the context of on-line communications in *Rule G-19 Interpretation — Notice Regarding Application of Rule G-19, on Suitability of Recommendations and Transaction, to Online Communications*, September 25, 2002, reprinted in *MSRB Rule Book*.

[4] Rule G-8(a)(x)(F) requires that dealers maintain records for each customer of such information about the customer used in making recommendations to the customer. Rule G-19(e), on churning, also prohibits a dealer from recommending transactions to a customer that are excessive in size or frequency, in view of information known to such dealer concerning the customer's financial background, tax status and investment objectives.

[5] *See Rule G-20 Interpretive Letter — Authorization of sales contests*, June 25, 1982, reprinted in *MSRB Rule Book*.

Bond Insurance Ratings — Application of MSRB Rules

January 22, 2008

Bond insurance companies recently have been subject to increased attention in the municipal securities market as a result of credit rating agency downgrades and ongoing credit agency reviews. Because of these recent events and the prominence of bond insurance in the municipal securities market, the MSRB is publishing this notice to review some of the investor protection rules applicable to brokers, dealers and municipal securities dealers ("dealers") effecting transactions in insured municipal securities.

Rule G-17 and Time of Trade Disclosure to Customers

One of the most important MSRB investor protection rules is Rule G-17, which requires dealers to deal fairly with all persons and prohibits deceptive, dishonest, or unfair practices. A long-standing interpretation of Rule G-17 is that a dealer transacting with a customer[1] must ensure that the customer is informed of all material facts concerning the transaction, including a complete description of the security.[2] Disclosure of material facts to a customer under Rule G-17 may be made orally or in writing, but must be made at or prior to the time of trade. In general, a fact is considered "material" if there is a substantial likelihood that its disclosure would have been considered significant by a reasonable investor.[3] As applied to customer transactions in insured municipal securities, the disclosures required under Rule G-17 include a description of the securities and identification of any bond insurance as well as material facts that relate to the credit rating of the issue. The disclosures required under Rule G-17 also may include material facts about the credit enhancement applicable to the issue.

March 2002 Notice

In a March 2002 Interpretative Notice, the MSRB provided specific guidance on the disclosure requirements of Rule G-17.[4] The March 2002 Notice clarified that, in addition to the requirement to disclose material facts about a transaction of which the dealer is specifically aware, the dealer is responsible for disclosing any material fact that has been made available through sources such as the NRMSIR system,[5] the Municipal Securities Information Library® (MSIL®) system,[6] RTRS,[7] *rating agency reports* and other sources of information relating to the municipal securities transaction generally used by dealers that effect transactions in the type of municipal securities at issue (collectively, "established industry sources").[8] The inclusion of "rating agency reports" within the list of "established industry sources" of information makes clear the Board's view that information about the rating of a bond, or information from the rating agency about potential rating actions with respect to a bond, may be material information about the transaction. It follows that, where the issue's credit rating is based in whole or in part on bond insurance, the credit rating of the insurance company, or information from the rating agency about potential rating actions with respect to the bond insurance company, may be material information about the transaction.

In addition to the actual credit rating of a municipal issue, "underlying" credit ratings are assigned by rating agencies to some municipal securities issues. An underlying credit rating is assigned to reflect the credit quality of an issue independent of credit enhancements such as bond insurance. The underlying rating (or the lack of an underlying rating)[9] may be relevant to a transaction when the credit rating of the bond insurer is downgraded or is the subject of information from the rating agency about a potential rating action with respect to the insurance company. In order to ensure all required disclosures are made under Rule G-17, a dealer must take into consideration information on underlying credit ratings that

Accessed from http://www.msrb.org. ©2020 Municipal Securities Rulemaking Board. All rights reserved.
MSRB is a registered trademark of the Municipal Securities Rulemaking Board.
Reprinted with permission of MSRB. Version date October 1, 2019.

is available in established industry sources (or information otherwise known to the dealer) and must incorporate such information when determining the material facts to be disclosed about the transaction.

April 2002 Notice on Sophisticated Municipal Market Professionals

In a notice dated April 30, 2002, the MSRB provided additional guidance on Rule G-17 and other customer protection rules as they apply to transactions with a special class of institutional customers known as "Sophisticated Municipal Market Professionals" ("SMMPs").[10] The April 2002 Notice provides a definition of SMMP, which includes critical elements such as the customer's financial sophistication and access to established industry sources for municipal securities information. When a dealer has reasonable grounds for concluding that the institutional customer is an SMMP as defined in the April 2002 Notice, the institutional customer necessarily is already aware, or capable of making itself aware of, material facts found in the established industry sources. In addition, the customer in such cases is able to independently understand the significance of such material facts.

The April 2002 Notice provides that a dealer's Rule G-17 obligation to affirmatively disclose material facts available from established industry sources is qualified to some extent in certain kinds of SMMP transactions. Specifically, when effecting non-recommended, secondary market transactions, a dealer is not required to provide an SMMP with affirmative disclosure of the material facts that already exist in established industry sources. This differs from the general Rule G-17 requirement of disclosure, discussed above, and therefore may be relevant to dealers trading with SMMPs in insured municipal securities.

Rule G-19 and Suitability Determinations

In addition to the customer disclosure obligations relating to bond insurance and credit ratings, dealers also should be aware of how suitability requirements of MSRB Rule G-19 relate to transactions in insured bonds that are recommended to customers. Rule G-19 provides that a dealer must consider the nature of the security as well as the customer's financial status, tax status and investment objectives when making recommendations to customers. The dealer must have reasonable grounds for believing that the recommendation is suitable, based upon information available about the security and the facts disclosed by or otherwise known about the customer.[11] Facts relating to the credit rating of a bond insurer may affect suitability determinations, particularly for customers that have conveyed to the dealer investment objectives relating to credit quality of investments. For example, if a customer has expressed the desire to purchase only "triple A" rated securities, recommendations to the customer should take into account information from rating agencies, including information about potential rating actions that may affect the future "triple A" status of the issue.[12]

Rule G-30 and Fair Pricing Requirements

Another important investor protection provision within MSRB rules is Rule G-30 on prices and commissions. Rule G-30 requires that, for principal transactions with customers, the dealer must ensure that the price of each transaction is fair and reasonable, taking into account all relevant factors. Dealers should consider the effect of ratings on the value of the securities involved in customer transactions, and should specifically consider the effect of information from rating agencies, both with respect to actual or potential changes in the underlying rating of a security and with respect to actual or potential changes in the rating of any bond insurance applicable to the security.

Rule G-15(a) and Confirmation Disclosure

The content of information required to be included on customer confirmations of municipal securities transactions is set forth in MSRB Rule G-15(a). For securities with additional credit backing, such as bond insurance, the rule requires the confirmation to state "the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service."[13] Rule G-15(a) does not generally require that credit agency ratings be included on customer confirmations. However, if credit ratings are given on the confirmation, the ratings must be correct.

Conclusion

Meeting the disclosure requirements of Rule G-17 requires attention to the facts and circumstances of individual transactions as well as attention to the specific securities and customers that are involved in those transactions. In light of recent events affecting credit ratings of bond insurance companies, dealers may wish to review both the March 2002 Notice on Rule G-17 disclosure requirements and the April 2002 Notice on SMMP transactions to ensure compliance with the rule in the changing environment for bond insurance companies. In addition, dealers may wish to review how transactions in insured securities are being recommended, priced and confirmed to customers to ensure compliance with other MSRB investor protection rules.

---

[1] The word "customer," as used in this notice, follows the definition in MSRB Rule D-9, which states that a "customer" is any person other than a broker, dealer, or municipal securities dealer acting in its capacity as such or an issuer in transactions involving the sale by the issuer of a new issue of its securities.

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

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

[4] Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, MSRB Notice (March 25, 2002) (hereinafter "March 2002 Notice").

[5] For purposes of this notice, the "NRMSIR system" refers to the disclosure dissemination system adopted by the SEC in SEC Rule 15c2-12.

[6] The MSIL® system collects and makes available to the marketplace official statements and advance refunding documents submitted under MSRB Rule G-36, on the delivery of official statements, as well as certain sec-

Accessed from http://www.msrb.org. ©2020 Municipal Securities Rulemaking Board. All rights reserved.
MSRB is a registered trademark of the Municipal Securities Rulemaking Board.
Reprinted with permission of MSRB. Version date October 1, 2019.

ondary market material event disclosures provided by issuers under SEC Rule 15c2-12. Municipal Securities Information Library® and MSIL® are registered trademarks of the MSRB.

[7] The MSRB's Real-Time Transaction Reporting System ("RTRS") collects and makes available to the marketplace information regarding inter-dealer and dealer-customer transactions in municipal securities.

[8] *See* March 2002 Notice (emphasis added).

[9] The lack of a rating for a municipal issue does not necessarily imply that the credit quality of such an issue is inferior, but is information that should be taken into account when accessing material facts about a transaction in the security.

[10] Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals (April 30, 2002) (hereinafter "April 2002 Notice").

[11] As with Rule G-17, the MSRB has provided specific qualifications with respect to how a dealer fulfills its suitability duties when making recommendations to SMMPs. These are described in the April 2002 Notice on SMMPs, discussed above.

[12] To assure that a dealer effecting a recommended transaction with a non-SMMP customer has the information needed about the customer to make its suitability determination, Rule G-19 requires the dealer to make reasonable efforts to obtain information concerning the customer's financial status, tax status and investment objectives, as well as any other information reasonable and necessary in making the recommendation. The obligations arising under Rule G-19 in connection with a recommended transaction require a meaningful analysis, taking into consideration the information obtained about the customer and the security, which establishes the reasonable grounds for believing that the recommendation is suitable. Such suitability determinations should be based on the appropriately weighted factors that are relevant in any particular set of facts and circumstances, which factors may vary from transaction to transaction. *See* Reminder of Customer Protection Obligations In Connection With Sales of Municipal Securities, MSRB Notice 2007-17 (May 30, 2007).

[13] The rule provides that, if there is more than one such obligor, the statement "multiple obligors" may be shown. If a security is unrated by a nationally recognized statistical rating organization, Rule G-15(a) requires dealers to disclose the fact that the security is unrated.

Notice on Bank Tying Arrangements, Underpricing of Credit and Rule G-17 on Fair Dealing

August 14, 2008

The Municipal Securities Rulemaking Board is concerned that the recent increase in demand for liquidity facilities in the municipal securities market due to the downgrade of the monoline insurers and the conversion of auction rate securities programs may result in certain activities that could violate federal bank tying and underpricing of credit prohibitions. The MSRB wishes to remind dealers of these prohibitions as well as the fact that any broker, dealer or municipal securities dealer ("dealer") that aids and abets a violation of federal bank tying or underpricing of credit prohibitions also would violate Rule G-17 on fair dealing.

Section 106 of the Bank Holding Company Act Amendments of 1970 prohibits commercial banks from imposing certain types of tying arrangements on their customers, a practice known as "tying." Tying includes conditioning the availability or terms of loans or other credit products on the purchase of certain other products and services. It is legal for banks to tie credit and traditional banking products, such as cash management, but it is not legal for banks to tie credit and debt underwriting from the bank or from the bank's investment affiliate. For example, a bank would violate Section 106 if the bank informs a customer seeking a liquidity facility from the bank that the bank will provide the liquidity facility only if the customer commits to hire the bank's securities affiliate to underwrite an upcoming bond offering for the customer. Section 106, however, does not prohibit a customer from deciding on its own to award some of its business to a bank or an affiliate as a reward for the bank previously providing credit or other business to the customer. So too, if a bank provides a reduced rate on a liquidity facility because of an illegal tie in with an underwriting, that may also constitute an underpricing of credit (*i.e.*, an extension of credit below market rates). The underpricing could violate Section 23B of the Federal Reserve Act of 1913 which generally requires that certain transactions between a bank and its affiliates occur on market terms and applies to any transaction by a bank with a third party if an affiliate has a financial interest in the third party or if an affiliate is a participant in the transaction.

The MSRB encourages all interested parties to provide information concerning any arrangement in which the provision of liquidity facilities may have been illegally tied to investment banking services. Such information may be provided to the appropriate bank regulatory authority or, if provided to the MSRB, the MSRB will forward it to the appropriate bank regulatory authority. In addition, the MSRB cautions that any dealer that aids or abets a violation of bank tying or the underpricing of credit prohibitions also would violate Rule G-17. A dealer would be deemed to have aided and abetted a violation of the bank tying prohibition or underpricing of credit if it knew or had reason to know that the purchase of investment banking services had been tied to the provision and/or pricing of a liquidity facility by an affiliated bank in violation of the federal banking laws.

Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities

July 14, 2009

Significant participation by individual investors has long been a hallmark of the municipal securities market and, consequently, a focus of the core investor protection efforts of the Municipal Securities Rulemaking Board (the "MSRB").[1] This Notice reminds brokers, dealers and municipal securities dealers ("dealers") of their sales practice obligations under MSRB rules as applied specifically to individual and other retail investors. Among other things, this Notice updates guidance to dealers on (i) their obligations to disclose material information about issuers, their securities and credit/liquidity support for such securities in connection with the fulfillment of their disclosure obligations under MSRB Rule G-17, (ii) their obligations to use such material information in fulfilling their suitability obligations under MSRB Rule G-19, and (iii) their fair pricing obligations under MSRB Rules G-18 and