dle customer complaints and to ensure that customer funds and securities are handled in accordance with the dealer's procedures.

It is the understanding and view of the Board that dealers possess the legal capacity to insist that mail addressed to their offices be deemed to be related to their businesses, even if marked to the attention of a particular associated person, if they advise associated persons that personal correspondence should not be received at their firms. Dealers, other than non-NASD member bank dealers, are reminded that SEC Rule 17a-4(b)(4) requires that "originals of all communications received . . . by such member, broker or dealer, relating to its business as such . . ." must be preserved for not less than three years.

The retention requirements of the amendments to rule G-27 cross reference rules G-8(a)(xx) and G-9(b)(viii) and (xiv) and state that the names of persons who prepared, reviewed and approved correspondence must be readily ascertainable from the retained records. The records must be made available, upon request, to the appropriate enforcement agency (*i.e.*, NASD or federal bank regulatory agency).

Guidelines for Supervision and Review

In adopting review procedures pursuant to rule G-27(d)(i), dealers must:

- specify, in writing, the dealer's policies and procedures for reviewing different types of correspondence;
- identify how supervisory reviews will be conducted and documented;
- identify what types of correspondence will be pre- or post-reviewed;
- identify the organizational position(s) responsible for conducting review of the different types of correspondence;
- specify the minimum frequency of the reviews for each type of correspondence;
- monitor the implementation of and compliance with the dealer's procedures for reviewing public correspondence; and
- periodically re-evaluate the effectiveness of the dealer's procedures for reviewing public correspondence and consider any necessary revisions.

In conducting reviews, dealers may use reasonable sampling techniques. As an example of appropriate evidence of review, e-mail related to the dealer's municipal securities activities may be reviewed electronically and the evidence of review may be recorded electronically.

In developing supervisory procedures for the review of correspondence with the public pursuant to rule G-27(d)(ii), each dealer must consider its structure, the nature and size of its business, other pertinent characteristics, and the appropriateness of implementing uniform firm-wide procedures or tailored procedures (*i.e.*, by specific function, office/location, individual, or group of persons).

In adopting review procedures pursuant to rule G-27(d)(ii), dealers must, at a minimum:

- specify procedures for reviewing municipal securities representatives' recommendations to customers;
- require supervisory review of some of each municipal securities representative's public correspondence, including recommendations to customers;
- consider the complaint and overall disciplinary history, if any, of municipal securities representatives and other employees (with particular emphasis on complaints regarding written or oral communications with clients); and
- consider the nature and extent of training provided municipal securities representatives and other employees, as well as their experience in using communications media (although a dealer's procedures may not eliminate or provide for minimal supervisory reviews based on an employee's training or level of experience in using communications media).

Although dealers may consider the number, size, and location of offices, as well as the volume of correspondence overall or in specific areas of the organization, dealers must nonetheless develop appropriate supervisory policies and procedures in light of their duty to supervise their associated persons. The factors listed above are not exclusive and dealers must consider all appropriate factors when developing their supervisory procedures and implementing their supervisory reviews.

Supervisory policy and procedures must also:

- provide that all customer complaints, whether received via e-mail or in written form from the customer, are kept and maintained;
- describe any dealer standards for the content of different types of correspondence; and
- prohibit municipal securities representatives' and other employees' use of electronic correspondence to the public unless such communications are subject to supervisory and review procedures developed by the dealer. For example, the Board would expect dealers to prohibit correspondence with customers from employees' home computers or through third party systems unless the dealer is capable of monitoring such communications.

The method used for conducting reviews of incoming, written correspondence to identify customer complaints and funds may vary depending on the dealer's office structure. Where the office structure permits review of all correspondence, dealers should designate a municipal securities representative or other appropriate person to open and review correspondence prior to use or distribution to identify customer complaints and funds. The designated person must not be supervised or

under the control of the municipal securities representative whose correspondence is opened and reviewed. Unregistered persons who have received sufficient training to enable them to identify complaints and funds would be permitted to review correspondence.

Where the office structure does not permit the review of correspondence prior to use or distribution, appropriate procedures that could be adopted include the following:

- forwarding opened incoming written correspondence related to the dealer's municipal securities activities to a designated office, or supervising branch office, for review on a weekly basis;
- maintenance of a separate log for all checks received and securities products sold, which is forwarded to the supervising branch office on a weekly basis;
- communication to clients that they can contact the dealer directly for any matter, including the filing of a complaint, and providing them with an address and telephone number of a central office of the dealer for this purpose; and
- branch examination verification that the procedures are being followed.

Regardless of the method used for initial review of incoming, written correspondence, as with other types of correspondence, rule G-27 would still require review by a designated principal of some of each municipal securities representative's correspondence with the public relating to the dealer's municipal securities activities. Given the complexity and cost of establishing appropriate systems for effectively reviewing electronic communications, some dealers may determine to conduct a pre-use or distribution review of all incoming and outgoing correspondence (written or electronic).

Dealers must continually assess the effectiveness of these supervisory systems. Education and training must be timely (prior to or concurrent with implementation of the policies and procedures) and must include all appropriate employees. Dealers may incorporate the required education and training on correspondence into their Continuing Education Firm Element Training Program (*see* rule G-3(h) on continuing education requirements). The requirement for training regarding correspondence may also apply to employees who are not included under the Continuing Education requirements.

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[1] *See* Exchange Act Release No. 42538 (March 16, 2000), 65 FR 15675 (March 23, 1999).

[2] *See* Securities Act Release No. 7288, Exchange Act Release No. 37182, Investment Company Act Release No. 21945, Investment Advisor Act Release No. 1562 (May 9, 1996), 61 FR 24644 (May 15, 1996) (File No. S7-13-96).

[3] *Id.*

[4] *See* Exchange Act Release No. 39510 (December 31, 1997), 63 FR 1131 (January 8, 1998).

[5] *See* Exchange Act Release No. 39511 (December 31, 1997), 63 FR 1135 (January 8, 1998).

[6] *See* Exchange Act Release No. 40723 (November 30, 1998), 63 FR 67496 (December 7, 1998).

[7] *See Notice to Members* 99-03 (January 1999).

See also:

Rule G-3 Interpretation — Notice Concerning Municipal Securities Sales Activities in Branch Affiliate and Correspondent Banks Which Are Municipal Securities Dealers, March 11, 1983.

Rule G-14 Interpretation — Build America Bonds and Other Tax Credit Bonds, April 24, 2009.

Rule G-17 Interpretations — Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans, August 7, 2006.

- **MSRB Reminds Firms of Their Sales Practice and Due Diligence Obligations When Selling Municipal Securities in the Secondary Market,** September 20, 2010.

Rule G-21 Interpretation — Interpretation on General Advertising Disclosures, Blind Advertisements and Annual Reports Relating to Municipal Fund Securities Under Rule G-21, June 5, 2007.

Rule G-29 Interpretation — Interpretive Notice on Availability of Board Rules, May 20, 1998.

Rule G-37 Interpretation — Reminder of Obligations Under Rule G-37 on Political Contributions and Rule G-27 on Supervision when Sponsoring Meetings and Conferences Involving Issuer Officials, March 26, 2007.

Interpretive Letters

Supervisory structure. This is in response to your letter of December 31, 1986 and our subsequent telephone conversation. You note that there has been a recent reorganization within your bank. As a consequence, you, as the head of the dealer department, now will report to the bank officer who also is in charge of the trust department and the bank's investment portfolio, rather than directly to the bank's president as had been the case. You ask whether this arrangement might constitute a conflict of interest under trust regulations or otherwise under Board rules.

Board rule G-27 places an obligation upon a dealer to supervise its municipal securities activities. It requires a dealer to accomplish this objective by designating individuals with supervisory responsibility for municipal securities activities and requires the dealer to adopt written supervisory procedures to this end. The rule does not specify how a dealer should structure its supervisory procedures, provided that the dealer adopts an organizational structure which meets the intent of the rule. You should review your dealer's written supervisory procedures to ensure that they provide for the appropriate delegation of supervisory responsibilities, given the reorganization within the bank.

You noted that the individual to whom you will be reporting is presently qualified as a municipal securities representative but not as a municipal securities principal. Board rule G-3(a)(i)[*] defines a municipal securities principal as an associated person of a securities firm or bank dealer who is directly engaged

in the management, direction or supervision of municipal securities activities. If, under the new reorganization, this individual will be designated with day-to-day responsibility for the management, direction or supervision of the municipal securities activities of the dealer, then he must be qualified as a municipal securities principal.

Finally, trust regulations are governed by the appropriate banking law and not by Board rules. Consequently, any concerns that you may have with respect to possible conflicts of interest with trust regulations should be directed to the appropriate bank regulatory agency. *MSRB interpretation of March 11, 1987.*

[*] [Currently codified at rule G-3(b)(i).]

Review and approval of transactions. This is in response to your letter requesting an interpretation of rule G-27(c)(ii)(B)[*] which requires that a [designated] principal promptly review and approve, in writing, each transaction in municipal securities. You state that your firm proposes to use a system of exception reports to review the firm's municipal securities transactions each day. Each trade will be reviewed by computer pursuant to parameters established by the Compliance Department. These parameters include the size of the order (in terms of dollars as well as a percentage of the customer's net worth), the customer's income, investment objectives and age. These parameters can be changed and fine-tuned as the situation dictates. Currently, the exception report will contain all purchases in excess of $25,000 or 10 percent of the customer's stated net worth and all sales in excess of $10,000. A review of the exception report would be conducted by a municipal securities principal. Oversight of the review process, and any required follow-up, would be conducted.

Rule G-27, on supervision, requires a dealer to supervise the municipal securities activities of its associated persons and the conduct of its business. In particular, rule G-27(c)(ii)(B)[*] requires that a [designated] principal promptly review and approve, in writing, each transaction in municipal securities. The Board believes that the requirement for written approval of *each* transaction by a [designated] principal is reasonable and necessary to promote proper supervision of the activities of municipal securities representatives. Among other purposes, these procedures enable [designated] principals to keep abreast of the firm's daily trading activity, to assess the appropriateness of mark-ups and mark-downs, and to assure that provisions for the prompt delivery of securities are being met. The exception reporting you propose would not comply with rule G-27(c)(ii)(B)[*] because it would not result in review and approval of each municipal securities transaction by a [designated] principal.[1] *MSRB interpretation of July 26, 1989.*

[1] While exception report review is not appropriate in complying with rule G-27(c)(vii)(B),[*] we understand that certain dealers, with the approval of their enforcement agencies, use exception reports in their periodic review of customer accounts required by rule G-27(c)(iii).

[*] [Currently codified at rule G-27(c)(i)(G)(2).]

NOTE: Revised to reflect subsequent amendments.

Review and approval of transactions. This is in response to your letter in which you ask several questions concerning Board rules.

[One paragraph deleted.][*]

With respect to your second question, someone qualified as both a municipal securities representative and as a municipal securities principal may review and approve his or her own transactions effected in the capacity as a representative.

With respect to your final question, rule G-27(c)(vii)(B)[†], on supervision, requires the prompt review and written approval by a designated principal of each transaction in municipal securities on a daily basis. *MSRB interpretation of June 20, 1994.*

[*] [The deleted paragraph concerned an unrelated question regarding a different Board rule and appears elsewhere in the *MSRB Rule Book*.]

[†] [Currently codified at rule G-27(c)(i)(G)(2).]

Review and approval of customer accounts. This is in response to your letter dated July 24, 1996, requesting an interpretation of rule G-27(c)(iii)[*] on written supervisory procedures.

Rule G-27(c)(iii)[*] requires that each municipal securities dealer adopt, maintain and enforce written supervisory procedures ensuring the "regular and frequent" review and approval by a designated principal of customer accounts introduced or carried by the dealer in which transactions in municipal securities are effected. The rule further states that such review shall be designed to ensure that such transactions are in accordance with all applicable rules and to detect and prevent irregularities and abuses.

Because circumstances vary from dealer to dealer, the Board has not specified a time period to define "regular and frequent" for purposes of rule G-27(c)(iii).[*] As you can see, however, the purpose of this provision is to detect and prevent irregularities and abuses that may occur in customer accounts. The Board expects dealers to establish procedures that effectively obtain this objective and that are capable of compliance. While the Board has never specifically addressed "risk-focused" methods for determining periodic account review, the Board has stated that, in determining when an account must be reviewed, a dealer might look to the volume and frequency of trading and the nature of the securities traded. The Board noted that account review guidelines based on these factors would be appropriate if they are articulated clearly in a dealer's written supervisory procedures.[1] *MSRB interpretation of August 7, 1996.*

[1] Supervision Requirements, *MSRB Reports*, Vol. 10, No. 2 (May 1990) at 6.

[*] [Currently codified at rule G-27(c)(i)(C).]

See also:

Rule G-8 Interpretive Letter — Use of electronic signatures, *MSRB interpretation of February 27, 1989.*

Rule G-37 Interpretive Letter — Solicitation of contributions, *MSRB interpretation of November 7, 1994.*

- **Supervisory procedures relating to indirect contributions: conference accounts and 527 organizations,** *MSRB interpretation of December 21, 2006.*

Rule G-27 Amendment History (since 2003)

Release No. 34-85699 (April 22, 2019), 84 FR 17897 (April 26, 2019); MSRB Notice 2019-11 (April 10, 2019)

Release No. 34-72743 (August 1, 2014), 79 FR 46290 (August 7, 2014); MSRB Notice 2014-13 (August 4, 2014)

Release No. 56796 (November 15, 2007), 72 FR 65786 (November 23, 2007); MSRB Reports 2007-32 (November 8, 2007)

Release No. 34-56478 (September 20, 2007), 72 FR 54702 (September 26, 2007); MSRB Reports 2007-27 (September 14, 2007)

Release No. 34-55830 (May 30, 2007), 72 FR 31122 (June 5, 2007); MSRB Notice 2007-18 (June 5, 2007)

Release No. 34-55792 (May 22, 2007), 72 FR 29564 (May 29, 2007); MSRB Notice 2007-16 (May 25, 2007)

Rule G-28
Transactions with Employees and Partners of Other Municipal Securities Professionals

(a) *Account Instructions*. No broker, dealer or municipal securities dealer shall open or maintain an account in which transactions in municipal securities may be effected for a customer who such broker, dealer or municipal securities dealer knows is employed by, or the partner of, another broker, dealer or municipal securities dealer, or for or on behalf of the spouse or minor child of such person unless such broker, dealer, or municipal securities dealer first gives written notice with respect to the opening and maintenance of such account to the broker, dealer or municipal securities dealer by whom such person is employed or of whom such person is a partner.

(b) *Account Transactions*. No broker, dealer, or municipal securities dealer shall effect a transaction in municipal securities with or for an account subject to section (a) of this rule unless such broker, dealer, or municipal securities dealer

(i) sends simultaneously to the employing broker, dealer or municipal securities dealer a duplicate copy of each confirmation sent to the customer, and

(ii) acts in accordance with any written instructions which may be provided to the broker, dealer or municipal securities dealer by an employing broker, dealer or municipal securities dealer with respect to transactions effected with or for such account.

(c) *Exemption for Municipal Fund Securities*. The provisions of this rule shall not be applicable to transactions in municipal fund securities or to accounts that are limited to transactions in municipal fund securities.

Rule G-28 Interpretations

See:

Rule G-32 Interpretation — Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers, November 20, 1998.

Interpretive Letter

Employer of customer's spouse. This will acknowledge receipt of your letter of January 10, 1979, requesting an interpretive opinion with respect to rule G-28 of the Municipal Securities Rulemaking Board (the "Board"). Rule G-28 requires a municipal securities dealer to take certain specified actions in connection with municipal securities transactions effected for the account of customers who are employed by, or the partner of another municipal securities dealer or for or on behalf of the spouse or minor child of such a person. I understand from a subsequent conversation which we had that your principal concern is whether a municipal securities dealer must obtain information regarding the employer of a spouse of a current customer, in view of the requirements of rule G-28.

Although rule G-28 applies to the spouse or minor child of a customer who is employed by another municipal securities dealer, there is no requirement at the present time in rule G-28 or in rule G-8, the recordkeeping rule, for a municipal securities dealer to obtain information about the employment status of spouses or minor children. Accordingly, a municipal securities dealer does not have to inquire of current customers whether their spouses are employed by another municipal securities dealer. A municipal securities dealer would have to comply with rule G-28 if the dealer actually knows that a spouse is employed by another municipal securities dealer. *MSRB interpretation of March 6, 1979*.

Rule G-29
RESERVED

Rule G-30
Prices and Commissions

(a) *Principal Transactions*. No broker, dealer or municipal securities dealer shall purchase municipal securities for its own account from a customer, or sell municipal securities for its own account to a customer, except at an aggregate price (including any mark-up or mark-down) that is fair and reasonable.

(b) *Agency Transactions*.

(i) Each broker, dealer and municipal securities dealer, when executing a transaction in municipal securities for or on behalf of a customer as agent, shall make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions.

(ii) No broker, dealer or municipal securities dealer shall purchase or sell municipal securities as agent for a customer for a commission or service charge in excess of a fair and reasonable amount.

Supplementary Material:

.01 General Principles.

(a) Each broker, dealer or municipal securities dealer (each, a "dealer," and collectively, "dealers"), whether effecting a trade on an agency or principal basis, must exercise reasonable diligence in establishing the market value of the security and the reasonableness of the compensation received on the transaction.

(b) A dealer effecting an agency transaction must exercise the same level of care as it would if acting for its own account.

(c) A "fair and reasonable" price bears a reasonable relationship to the prevailing market price of the security.

(d) Dealer compensation on a principal transaction with a customer is considered to be a mark-up or mark-down that is computed from the prevailing market price at the time of the customer transaction, as described in Supplementary Material .06. As part of the aggregate price to the customer, the mark-up or mark-down also must be a fair and reasonable amount, taking into account all relevant factors.

(e) Reasonable compensation differs from fair pricing. A dealer could restrict its profit on a transaction to a reasonable level and still violate this rule if the dealer fails to consider market value. For example, a dealer may fail to assess the market value of a security when acquiring it from another dealer or customer and as a result may pay a price well above market value. It would be a violation of fair-pricing responsibilities for the dealer to pass on this misjudgment to another customer, as either principal or agent, even if the dealer makes little or no profit on the trade.

.02 Relevant Factors in Determining the Fairness and Reasonableness of Prices.

(a) The most important factor in determining whether the aggregate price to the customer is fair and reasonable is that the yield should be comparable to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market.

(b) Other factors include, but are not limited to:

(i) the best judgment of the dealer concerning the fair market value of the securities when the transaction occurs and, where applicable, of any securities exchanged or traded in connection with the transaction;

(ii) the expense involved in effecting the transaction;

(iii) that the dealer is entitled to a profit;

(iv) the total dollar amount of the transaction;

(A) To the extent that institutional transactions are often larger than retail transactions, this factor may enter into the fair and reasonable pricing of retail versus institutional transactions.

(v) the service provided in effecting the transaction;

(vi) the availability of the securities in the market;

(vii) the rating and call features of the security (including the possibility that a call feature may not be exercised);

(A) A dealer should 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.

(B) A dealer pricing securities on the basis of yield to a specified call feature should consider the possibility that the call feature may not be exercised. Accordingly, the price to be paid by a customer should reflect this possibility and the resulting yield to maturity should bear a reasonable relationship to yields on securities of similar quality and maturity. Failure to price securities in this manner may constitute a violation of this rule because the price may not be "fair and reasonable" if the call feature is not exercised. That a customer in these circumstances may realize a yield greater than the yield at which the transaction was effected does not relieve a municipal securities professional of its responsibility under this rule.

(viii) the maturity of the security;

(ix) the nature of the dealer's business; and

(x) the existence of material information about a security available through EMMA or other established industry sources.

.03 Relevant Factors in Determining the Fairness and Reasonableness of Commissions or Service Charges.

(a) A variety of factors may affect the fairness and reasonableness of a commission or service charge, including:

(i) the availability of the securities involved in the transaction;

(ii) the expense of executing or filling the customer's order;

(iii) the value of the services rendered by the dealer;

(iv) the amount of any other compensation received or to be received by the dealer in connection with the transaction;

(v) that the dealer is entitled to a profit;

(vi) the total dollar amount and price of the transaction;

(vii) the best judgment of the dealer concerning the fair market value of the securities when the transaction occurs and of any securities exchanged or traded in connection with the transaction; and

(viii) for a dealer that sells municipal fund securities, whether the dealer's commissions or other fees fall within the sales charge schedule specified in Rule 2830 of the National Association of Securities Dealers, Inc. (Such compliance with Rule 2830 may, depending upon the facts and circumstances, be a significant, though not dispositive, factor in determining whether a commission or other fee is fair and reasonable.)

.04 Fair-Pricing Responsibilities and Large Price Differentials.

(a) A transaction chain that results in a large difference between the price received by one customer and the price paid by another customer for the same block of securities on the same day, without market information or news accounting for the price volatility, raises the question as to whether each of these customers received a price reasonably related to the market value of the security, and whether the dealers effecting the customer transactions (and any broker's brokers that may have acted on behalf of such dealers) made sufficient effort to establish the market value of the security when effecting their transactions.

(b) The lack of a well-defined and active market for an issue does not negate the need for diligence in determining the market value as accurately as reasonably possible when fair-pricing obligations apply. Although intra-day price differentials for obscure and illiquid issues might generally be larger than for more well-known and liquid issues, dealers must establish market value as accurately as possible using reasonable diligence under the facts and circumstances. For example, when a dealer is unfamiliar with a security, the efforts necessary to establish its value may be greater than if the dealer is familiar with the security.

(i) A dealer may need to review recent transaction prices for the issue or transaction prices for issues with similar credit quality and features as part of its duty to use diligence to determine the market value of municipal securities. When doing this, the dealer often will need to use its professional judgment and market expertise to identify comparable securities and to interpret the impact of recent transaction prices on the value of the block of municipal securities in question.

(ii) If the features and credit quality of the issue are unknown, it also may be necessary to obtain information on these factors directly or indirectly from an established industry source. For example, the current rating or other information on credit quality, the specific features and terms of the security, and any material information about the security such as issuer plans to call the issue, defaults, etc., all may affect the market value of securities.

(c) A bid-wanted procedure is not always a conclusive determination of market value. Therefore, particularly when the market value of an issue is unknown, a dealer may need to check the results of the bid-wanted process against other objective data to fulfill its fair-pricing obligations.

.05 Pricing Irregularities on Alternative Trading Systems.

Although the duty under section (b)(i) of this rule to evaluate the prices of certain individual transactions is eliminated under Rule G-48 when they are effected for sophisticated municipal market professionals, a dealer operating an alternative trading system must, under the general duty set forth in section (b)(i), act to investigate any alleged pricing irregularities on its system brought to its attention. Accordingly, a dealer operating an alternative trading system may be in violation of section (b)(i) if it fails to take actions to address system or participant pricing abuses.

.06 Mark-Up Policy

(a) Prevailing Market Price

(i) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. Presumptively for purposes of this Supplementary Material .06, the prevailing market price for a municipal security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with applicable MSRB rules. (See, e.g., Rule G-18).

(ii) When the dealer is selling the municipal security to a customer, other evidence of the prevailing market price may be considered only where the dealer made no contemporaneous purchases of the security or can show that in the particular circumstances the dealer's contemporaneous cost is not indicative of the prevailing market price. When the dealer is buying the municipal security from a customer, other evidence of the prevailing market price may be considered only where the dealer made no contemporaneous sales of the security or can show that in the particular circumstances the dealer's contemporaneous proceeds are not indicative of the prevailing market price.

(iii) A dealer's cost is (or proceeds are) considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the municipal security.

(iv) A dealer that effects a transaction in municipal securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost (or, in a mark-down, the dealer's own proceeds) must be prepared to provide evidence that is sufficient to overcome the presumption that such contemporaneous cost (or proceeds) provides the best measure of the prevailing market price. A dealer may be able to show that such contemporaneous cost is (or proceeds are) not indicative of prevailing market price, and thus overcome the presumption, in instances where: (A) interest rates changed after the dealer's contemporaneous transaction to a degree that such change would reasonably cause a change in municipal securities pricing; (B) the credit quality of the municipal security changed significantly after the dealer's contemporaneous transaction; or (C) news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the municipal security after the dealer's contemporaneous transaction.

(v) In instances where the dealer has established that the dealer's cost is (or, in a mark-down, proceeds are) not contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or proceeds) provides the best measure of the prevailing market price, such as those instances described in (a)(iv)(A), (B) and (C), the dealer must consider, in the order listed and subject to (a)(viii), the following types of pricing information to determine prevailing market price:

(A) Prices of any contemporaneous inter-dealer transactions in the municipal security in question;

(B) In the absence of transactions described in (A), prices of contemporaneous dealer purchases (sales) in the municipal security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same municipal security; or

(C) In the absence of transactions described in (A) and (B), for actively traded municipal securities, contemporaneous bid (offer) quotations for the municipal security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations.

(A dealer may consider a succeeding category of pricing information only when the prior category does not generate relevant pricing information (e.g., a dealer may consider pricing information under (B) only after the dealer has determined, after applying (A), that there are no contemporaneous inter-dealer transactions in the same security).) In reviewing the pricing information available within each category, the relative weight, for purposes of identifying prevailing market price, of such information (i.e., a particular transaction price or quotation) depends on the facts and circumstances of the comparison transaction or quotation (e.g., whether the dealer in the comparison transaction was on the same side of the market as the dealer in the subject transaction and timeliness of the information). Because of the lack of active trading in most municipal securities, it is not always possible to establish the prevailing market price for a municipal security based solely on contemporaneous transaction prices or contemporaneous quotations for the security. Accordingly, dealers may often need to consider other factors, consistent with (a)(vi) and (a)(vii) below.

(vi) In the event that, in particular circumstances, the above factors are not available, other factors that may be taken into consideration (not in any required order or combination) for the purpose of establishing the price from which a customer mark-up (mark-down) may be calculated, include but are not limited to:

- Prices, or yields calculated from prices, of contemporaneous inter-dealer transactions in a "similar" municipal security, as defined below;
- Prices, or yields calculated from prices, of contemporaneous dealer purchase (sale) transactions in a "similar" municipal security with institutional accounts with which any dealer regularly effects transactions in the "similar" municipal security with respect to customer mark-ups (mark-downs); and
- Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in "similar" municipal securities for customer mark-ups (mark-downs).

The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the factors set forth above depends on the facts and circumstances surrounding the comparison transaction (i.e., whether the dealer in the comparison transaction was on the same side of the market as the dealer in the subject transaction, timeliness of the information, and, with respect to the final factor listed above, the relative spread of the quotations in the similar municipal security to the quotations in the subject security).

(vii) Finally, if information concerning the prevailing market price of the subject municipal security cannot be obtained by applying any of the above factors, dealers (and the regulatory agencies responsible for enforcing MSRB rules) may consider as a factor in assessing the prevailing market price of a municipal security the prices or yields derived from economic models (e.g., discounted cash flow models) that take into account measures such as reported trade prices, credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (e.g., coupon frequency and accrual methods).

(viii) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. For example, in considering the pricing information described in (a)(v), a dealer may give little or no weight to pricing information derived from an isolated transaction or quotation, such as an off-market transaction. In addition, in considering yields of "similar"

municipal securities, except in extraordinary circumstances, dealers may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in "similar" municipal securities taken as a whole.

(b) "Similar" Municipal Securities

(i) A "similar" municipal security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the municipal security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the "similar" security or securities. Where a municipal security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

(ii) The degree to which a municipal security is "similar," as that term is used in this Supplementary Material .06, to the subject security may be determined by all relevant factors, including but not limited to the following:

(A) Credit quality considerations, such as whether the municipal security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as "similar" securities, significant recent information concerning either the "similar" security's issuer or subject security's issuer that is not yet incorporated in credit ratings should be considered (e.g., changes to ratings outlooks));

(B) The extent to which the spread (i.e., the spread over an applicable index or U.S. Treasury securities of a similar duration) at which the "similar" municipal security trades is comparable to the spread at which the subject security trades;

(C) General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the structure, callability, the likelihood that the municipal security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security;

(D) Technical factors such as the size of the issue, the float and recent turnover of the issue, and legal restrictions on transferability as compared with the subject security; and

(E) The extent to which the federal and/or state tax treatment of the "similar" municipal security is comparable to such tax treatment of the subject security.

(iii) When a municipal security's value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, pricing information with respect to other securities may not be used to establish the prevailing market price.

Rule G-30 Interpretations

Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities

December 19, 2001

The Municipal Securities Rulemaking Board ("MSRB") has received various inquiries regarding commissions, disclosures (including delivery of disclosure materials to the MSRB) and advertisements relating to municipal fund securities, particularly in connection with sales of interests in so-called Section 529 college savings plans.[1] The nature of the commissions and other program fees that may exist with respect to municipal fund securities may differ significantly from such charges that typically may exist for traditional debt securities sold in the municipal securities market. In many cases, commissions and other fees may more closely resemble those charged in connection with investment company securities registered under the Investment Company Act of 1940 (the "Investment Company Act").[2] Although commissions and fees charged by brokers, dealers and municipal securities dealers ("dealers") effecting transactions in municipal fund securities are subject to MSRB rules, the nature and level of fees and charges collected by other parties in connection with such securities generally are not subject to regulation. However, under certain circumstances, a dealer selling municipal fund securities may be obligated to disclose to customers such fees and charges collected by other parties.

Amount of Dealer's Commissions or Service Charges

Rule G-30(b), on prices and commissions in agency transactions, prohibits dealers from selling municipal securities to a customer for a commission or service charge in excess of a fair and reasonable amount. In assessing the fairness and reasonableness of the commission or service charge, the rule permits the dealer to take into consideration all relevant factors, including the availability of the securities involved in the transaction, the expense of executing or filling the customer's order, the value of the services rendered by the dealer, and the amount of any other compensation received or to be received by the dealer in connection with the transaction. The MSRB has received inquiries as to whether the sales charge schedule set out in Rule 2830 of the National Association of Securities Dealers, Inc. ("NASD") applies to or otherwise is indicative of the levels of commissions and other fees that dealers may charge in connection with sales of municipal fund securities.

MSRB rules, not those of the NASD, apply to sales by dealers of municipal securities, including municipal fund securities. NASD Rule 2830 provides that no member firm may offer or sell shares in investment companies registered under the In-

vestment Company Act if the sales charges are excessive. The NASD rule then sets forth various levels of aggregate sales charges to which member firms must conform, depending upon the nature of the investment company's sales charges, in order to ensure that such sales charges are not deemed excessive. The MSRB notes that the NASD derives its authority for the sales charge provisions of Rule 2830 from Section 22(b)(1) of the Investment Company Act, which expressly exempts such provisions from the limitation that Section 15A(b)(6) of the Securities Exchange Act of 1934 (the "Exchange Act") places on the NASD's ability to adopt rules that "impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members." In sharp contrast, no exemption exists from the limitations that Section 15B(b)(2)(C) of the Exchange Act places on the MSRB's ability to adopt rules that "impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by municipal securities brokers or municipal securities dealers." The MSRB believes that it could not, by rule or interpretation, in effect impose such a schedule for the sale of municipal fund securities.

Nonetheless, the MSRB believes that the charges permitted by the NASD under its Rule 2830 in connection with the sale of registered investment company securities may, depending upon the facts and circumstances, be a significant factor in determining whether a dealer selling municipal fund securities is charging a commission or other fee that is fair and reasonable. For example, the MSRB believes that charges for municipal fund securities transactions in excess of those permitted for comparable mutual fund shares under NASD Rule 2830 may be presumed to not meet the fair and reasonable standard under MSRB rule G-30(b), although the totality of the facts and circumstances relating to a particular transaction in municipal fund securities may rebut such presumption. Further, depending upon the specific facts and circumstances, a sales charge for a transaction in a municipal fund security that would be deemed in compliance with NASD Rule 2830 if charged in connection with a transaction in a substantially identical registered investment company security often will be in compliance with rule G-30(b).

However, the NASD schedule is not dispositive nor is it always the principal factor in determining compliance with rule G-30. The MSRB believes that the factors enunciated in rule G-30(b) and other relevant factors must be given due weight in determining whether a commission is fair and reasonable. These factors include, but are not limited to, the value of the services rendered by the dealer and the amount of any other compensation received or to be received by the dealer in connection with the transaction from other sources (such as the issuer). A dealer may not exclusively rely on the fact that its commissions fall within the NASD schedule, particularly where commission levels in the marketplace for similar municipal fund securities sold by other dealers providing similar levels of services are generally substantially lower than those charged by such dealer, taking into account any other compensation.

Disclosure of Program Fees and Charges of Other Parties

MSRB rules do not explicitly require disclosure by dealers of fees and charges received by other parties to a transaction. These can include, among other things, administrative fees of the issuer, investment adviser and other parties payable from trust assets or directly by the customer. However, depending upon the facts and circumstances, certain MSRB rules may have the practical effect of requiring some level of disclosure of such fees and charges to the extent that they are material. For example, rule G-32(a)(i) generally obligates the dealer to provide an official statement to its customer in connection with sales of municipal fund securities. Although MSRB rules do not govern the content of the disclosures included by the issuer in the official statement, the MSRB believes that an official statement prepared by an issuer of municipal fund securities that is in compliance with Exchange Act Rules 10b-5 and 15c2-12 generally would provide disclosure of any fees or other charges imposed in connection with such securities that are material to investors. The MSRB further believes that, in most respects, the disclosures provided by the issuer in the official statement would provide the dealer with the type of information it is required to disclose to customers under the MSRB's fair dealing rule, rule G-17.

Advertisements

Dealer advertisements of municipal fund securities must comply with the requirements of rule G-21.[3] This rule prohibits dealers from publishing advertisements concerning municipal securities which they know or have reason to know are materially false or misleading. The MSRB has previously stated that any use of historical yields in an advertisement would be subject to this prohibition. Thus, a dealer advertisement of municipal fund securities that refers to yield typically would require a description of the nature and significance of the yield shown in the advertisement in order to assure that such advertisement is not false or misleading. Further, depending upon the facts and circumstances, a dealer may be required to disclose information regarding a fee or other charge relating to municipal fund securities that may have a material effect on such advertised yield, to the extent that such disclosure is necessary to ensure that the advertisement is not materially false or misleading with respect to such yield.

The MSRB understands that advertisements and other sales material relating to registered investment company securities are, depending upon the nature of the advertisement, subject to the requirements of Securities Act Rule 156, on investment company sales literature, Securities Act Rule 482, on advertising by an investment company as satisfying requirements of section 10, and NASD Rule 2210, on communications with the public (including IM-2210-3, on use of rankings in investment companies advertisements and sales literature), among