

Client Alert

Current Issues Relevant to Our Clients

September 30, 2013

MSRB Proposes to Consolidate and Harmonize Fair Dealing Obligations

The Municipal Securities Rulemaking Board (the “MSRB”) recently filed several rule proposals with the Securities and Exchange Commission (the “SEC”) that focus on fair dealing obligations of dealers in municipal securities. The rule proposals include proposed MSRB Rule G-47 (Time of Trade Disclosure), proposed revisions to MSRB Rule G-19 (Suitability), proposed MSRB Rules D-15 and G-48 (Sophisticated Municipal Market Professionals), and proposed revisions to certain related interpretive guidance. The filing follows a series of requests made by the MSRB earlier this year for comments on the proposed rules changes. After considering the comments received, the MSRB has decided to ask the SEC to approve the rules changes generally as they were initially proposed. The MSRB notes that the proposals are intended to make the rules easier to understand and more consistent with other regulators. The proposed rules would follow the simplified format used by the Financial Industry Regulatory Authority (“FINRA”) and other self-regulatory organizations, consisting of rule language followed by supplementary material, which the MSRB intends to generally transition to all of its rules going forward. The text of the MSRB proposal is available [here](#).

Time of Trade Disclosure

Current MSRB Rule G-17 requires brokers, dealers, municipal securities dealers (collectively, “dealers”) and municipal advisers to deal fairly with all persons and not engage in deceptive, dishonest or unfair practices. The MSRB has interpreted Rule G-17 to require dealers to disclose to customers, at or prior to the time of a municipal securities trade, all “material” information about the transaction known by the dealer as well as “material” information about the security that is “reasonably accessible to the market.” Proposed MSRB Rule G-47 would consolidate most of the existing interpretive guidance into rule language that is not intended to substantively change current obligations, but present such obligations in a format intended to be easier-to-understand.

Proposed Rule G-47 would state that information is considered to be “material” if there is a substantial likelihood that the information would be considered important or significant by a reasonable investor in making an investment decision. The rule would also define information that is “reasonably accessible to the market” as information that is made available publicly through “established industry sources” such as the MSRB’s Electronic Municipal Market Access (“EMMA”) system, rating agency reports, and other sources generally used by dealers that effect transactions in the type of municipal

securities at issue. Supplementary material to the proposed rule would provide general information regarding the manner and scope of required disclosure, would note that dealers operating electronic trading systems have the same disclosure obligations, would provide examples describing information that may be material in specific situations, and would note that dealers are required to implement processes and procedures reasonably designed to ensure that material information is disseminated to applicable registered representatives.

Suitability

The MSRB proposal would more closely harmonize existing MSRB Rule G-19 (Suitability of Recommendations and Transactions) with FINRA Rule 2111 (Suitability) and would consolidate existing interpretive guidance addressing suitability into the revised Rule G-19. The basic suitability obligation in proposed MSRB Rule G-19 essentially mirrors FINRA Rule 2111 but takes a different approach with respect to institutional investor accounts. New MSRB Rule G-19 would not include the language on institutional investor accounts that is included in FINRA Rule 2111(b). Instead, the MSRB intends to apply existing guidance under MSRB Rule G-17 (essentially a “fair dealing” rule). The MSRB intent appears to be to provide a similar result as FINRA Rule 211(b) without incorporating a provision into MSRB Rule G-19 itself. The existing guidance under Rule G-17 provides that where a dealer

has reasonable grounds for concluding that a customer is a “sophisticated municipal market professional,” then the dealer’s obligation to determine that a recommendation is suitable for that particular customer is fulfilled. This interpretation deals only with guidance regarding how a dealer will fulfill “customer-specific suitability obligations” under Rule G-19 and does not address the suitability obligation to have a “reasonable basis” to believe that the recommendation could be suitable for at least some customers.

In response to a comment received, the MSRB confirmed that it will interpret proposed Rule G-19 in a manner consistent with FINRA’s interpretations of FINRA Rule 2111 except to the extent that the MSRB affirmatively states that specific provisions of FINRA’s interpretations do not apply. For further discussion about the proposed suitability harmonization and FINRA Rule 2111, please see our March 14, 2013 Client Alert available [here](#).

Sophisticated Municipal Market Professionals

Proposed MSRB Rules D-15 and G-48 on sophisticated municipal market professionals (“SMMPs”) would codify existing MSRB Rule G-17 guidance regarding the application of MSRB rules to transactions with SMMPs. The proposed rules would preserve and codify the substance of interpretive guidance previously issued by the MSRB into proposed Rule D-15, which defines an SMMP, and Rule G-48, which would describe the obligations applicable to SMMPs.

Proposed MSRB Rule D-15 would define an SMMP as a customer of a dealer that (i) is a bank, savings and loan association, insurance company, registered investment company, registered investment adviser, or any other entity with total assets of at least \$50 million, and (ii) the dealer has a reasonable basis to believe is capable of evaluating investment risks and market value independently, both in general and with respect to particular transactions and investment strategies in municipal securities, and affirmatively indicates that it is exercising independent judgment in evaluating the dealer’s recommendations. The supplementary material would state that a customer may affirm its independent judgment either orally or in writing, and may be given on a trade-by-trade basis, for each type of municipal security, or for an entire account.

Proposed MSRB Rule G-48 would modify the existing obligations dealers have to SMMPs as follows:

- Dealers would not have any obligation under proposed MSRB Rule G-47 to disclose material information that is reasonably accessible to the market;
- Dealers would not be obligated pursuant to MSRB Rule G-18 to take action to ensure that transactions meeting certain stipulated conditions are effected at fair and reasonable prices;
- Dealers would not have any obligation under proposed MSRB Rule G-19 to perform a customer-specific suitability analysis; and
- With respect to the bona fide quotations obligation in MSRB Rule G-13, a dealer disseminating an SMMP’s quotation which is labeled as such shall apply the same standards described in MSRB Rule G-13(b) for quotations made by another dealer.

For More Information

To discuss any topic covered in this client alert, please contact an attorney in our Investment Management Group or visit us online at chapman.com.

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