MSRB
Municipal Securities Rulemaking Board

Regulatory Notice

2016-03

Publication Date
January 13, 2016

Stakeholders
Municipal Securities Dealers, Municipal Advisors, Issuers, General Public

Notice Type
Approval Notice

Effective Date
June 23, 2016

Category
Fair Practice

Affected Rules
Rule G-42, Rule G-8

SEC Approves New MSRB Rule G-42 on Duties of Non-Solicitor Municipal Advisors and Related Amendments to MSRB Rule G-8

Overview

The Municipal Securities Rulemaking Board (MSRB) received approval from the Securities and Exchange Commission (SEC) of new MSRB Rule G-42, on duties of non-solicitor municipal advisors, and related amendments to MSRB Rule G-8, on books and records to be made by brokers, dealers, municipal securities dealers, and municipal advisors, on December 23, 2015.[1]

New Rule G-42 establishes core standards of conduct for municipal advisors that engage in municipal advisory activities, other than municipal advisory solicitation activities (for purposes of this notice and Rule G-42, "municipal advisors"). The related amendments to Rule G-8 establish recordkeeping requirements that apply when a municipal advisor makes a suitability determination or reviews the recommendation of another party. The adoption of Rule G-42 and the related amendments to Rule G-8 represent another significant milestone in the MSRB's development of a comprehensive regulatory framework for municipal advisors in the exercise of the rulemaking authority granted to the MSRB by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"),[2] and furthers the MSRB's mandate to protect municipal entities, obligated persons, investors and the public interest.

Rule G-42 and the related amendments to Rule G-8 will become effective on June 23, 2016.

[1] *See* Securities Exchange Act of 1934 ("Exchange Act") Release No. 76753 (December 23, 2015), 80 FR 81614 (December 30, 2015) (order approving SR-MSRB-2015-03). Refer to the rule text, included below, and the official rulemaking record for additional detail.

[2] Pub. Law No. 111-203, 124 Stat. 1376 (2010).

Questions about this notice may be directed to Michael L. Post, General Counsel – Regulatory Affairs, Sharon Zackula, Associate General Counsel, or Benjamin Tecmire, Counsel, at 202-838-1500.

Background on the Development of Rule G-42

Important material related to the development of Rule G-42 and the amendments to Rule G-8 is listed below:

- SEC Approval Order (December 23, 2015)[3]
- MSRB's Second Response to Comments (December 16, 2015)[4]
- Notice of Amendment No. 2 (November 17, 2015)[5]
- Notice of Amendment No. 1 (August 25, 2015)[6]
- MSRB's First Response to Comments (August 12, 2015)[7]
- SEC Notice of Proposed Rule G-42 (May 8, 2015)[8]
- MSRB's Second Notice Requesting Comment on Draft Rule G-42 (July 23, 2014)[9]
- MSRB's First Notice Requesting Comment on Draft Rule G-42 (January 9, 2014)[10]

In developing Rule G-42, the MSRB sought to create a set of requirements that would be consistent with the mandates of the Dodd-Frank Act, and the fiduciary duty it imposes upon municipal advisors in their relationships with municipal entity clients. The MSRB requested public comment to achieve these objectives and to understand, address and balance the concerns and needs of the recipients of municipal advisory services; institutional and retail investors; the constituents of municipal entities and the public; and financial

[3] *Supra* n.1.

[4] Letter to Secretary, SEC, from Michael L. Post, General Counsel – Regulatory Affairs, Response to Comments on SR-MSRB-2015-03, dated December 16, 2015.

[5] Exchange Act Release No. 76420 (November 10, 2015), 80 FR 71858 (November 17, 2015).

[6] Exchange Act Release No. 75737 (August 19, 2015), 80 FR 51645 (August 25, 2015).

[7] Letter to Secretary, SEC, from Michael L. Post, General Counsel – Regulatory Affairs, Response to Comments on SR-MSRB-2015-03, dated August 12, 2015.

[8] Exchange Act Release No. 74860 (May 4, 2015), 80 FR 26752 (May 8, 2015).

[9] MSRB Notice 2014-12 (July 23, 2014) ("Second Request for Comment").

[10] MSRB Notice 2014-01 (January 9, 2014) ("First Request for Comment").

intermediaries that are providers of municipal advisory services, other financial services or products, or a combination thereof. As part of this process, prior to the filing of the rule change with the SEC, the MSRB twice requested comment on draft versions of Rule G-42 and evaluated the comments, and revised draft Rule G-42 to address issues and concerns raised by commenters. After filing proposed Rule G-42 (SR-MSRB-2015-03) with the SEC, and at each stage preceding the SEC's approval of Rule G-42, the MSRB carefully considered all comments submitted, as reflected in a number of revisions to the rule text that were responsive to or derivative of comments received. The MSRB believes that the development of Rule G-42 was greatly enhanced by the active participation of commenters and is appreciative of their engagement in its development.

Summary of Rule G-42

Rule G-42 establishes the core standards of conduct and duties of municipal advisors when engaging in municipal advisory activities. The rule draws on aspects of existing law and regulation from other relevant regulatory regimes. In summary, Rule G-42:

- Establishes certain standards of conduct consistent with the fiduciary duty owed by a municipal advisor to its municipal entity clients, which includes a duty of care and a duty of loyalty;
- Requires a municipal advisor to exercise due care when performing its municipal advisory activities for its obligated person clients;
- Provides for the full and fair disclosure, in writing, of all material conflicts of interest and all legal or disciplinary events that are material to a client's evaluation of a municipal advisor;
- Requires documentation of the municipal advisory relationship, specifying certain aspects of the relationship that must be included in the documentation;
- Requires, when making a recommendation, that a municipal advisor have a reasonable basis to believe that the recommendation is suitable and, if appropriate, requires a municipal advisor to determine the suitability of recommendations made by third parties;
- Specifically prohibits a municipal advisor from engaging in certain activities, including, in summary:
    - receiving excessive compensation;
    - delivering inaccurate invoices for fees or expenses;
    - making false or misleading representations about the municipal advisor's resources, capacity or knowledge;
    - participating in certain fee-splitting arrangements with underwriters;

- participating in any undisclosed fee-splitting arrangements with providers of investments or services to a municipal entity or obligated person client of the municipal advisor;
- making payments for the purpose of obtaining or retaining an engagement to perform municipal advisory activities, with limited exceptions;
- engaging in certain principal transactions with its municipal entity clients, subject to a narrow exception for fixed income securities transactions; and

- Defines key terms.

In addition, the supplementary material to Rule G-42 provides additional guidance on core concepts in the rule, such as the duty of care and the duty of loyalty, and information on other important issues, including options available to a municipal advisor under which it would not be specifically prohibited from engaging in certain principal transactions with its municipal entity clients. Rule G-42 and its supplementary material are discussed in greater detail in the sections that follow.

Standards of Conduct — Rule G-42(a)

Section (a) of Rule G-42 establishes some of the core standards of conduct and duties applicable to municipal advisors.

Subsection (a)(i) of Rule G-42 provides that each municipal advisor in the conduct of its municipal advisory activities for an obligated person client is subject to a duty of care. Paragraph .01 of the supplementary material ("SM"), discussed below, provides guidance on the duty of care. Subsection (a)(ii) provides that each municipal advisor in the conduct of its municipal advisory activities for a municipal entity client is subject to a fiduciary duty, which includes a duty of loyalty and a duty of care. SM .02, discussed below, provides guidance on the duty of loyalty. Rule G-42(a) follows the Dodd-Frank Act in deeming a municipal advisor to owe a fiduciary duty, for purposes of Rule G-42, only to its municipal entity clients.[11]

The MSRB intended from the inception of the Rule G-42 rulemaking initiative not to comprehensively set forth every aspect of the duties and obligations that municipal advisors owe to their clients, and, in particular, every aspect of the fiduciary duty that may be owed under the broad fiduciary principle that Congress determined should apply with respect to municipal entity

[11] *See* Section 15B(c)(1) of the Exchange Act, 15 U.S.C. 78o-4(c)(1).

clients. Instead, Rule G-42 is designed primarily to set forth the core elements of the fiduciary duty and provide guidance on certain conduct that is likely to occur and issues that are likely to arise in the provision of municipal advisory services.

Municipal advisors should note that the standards in Rule G-42(a)(i) and (ii) do not supersede any more restrictive provisions of state or other laws applicable to the activities of municipal advisors, as specified in SM .08.

Supplementary Material Regarding Duty of Care, Duty of Loyalty and Related Issues. SM .01 and .02 provide guidance on the duty of care and the duty of loyalty. Generally, these provisions are designed to protect municipal entity and obligated person clients, provide regulatory guidance with respect to the duties of municipal advisors and empower the client, with the consent of the municipal advisor, to control the engagement and determine the scope of services to be provided.

Duty of Care. The duty of care includes, but is not limited to, the specific obligations set forth in SM .01. Under SM .01, a municipal advisor is required to:

- Possess the degree of knowledge and expertise needed to provide the municipal entity or obligated person client with informed advice;
- Make a reasonable inquiry as to the facts that are relevant to a client's determination as to whether to proceed with a course of action or that form the basis for any advice provided to the client;
- Undertake a reasonable investigation to determine that the municipal advisor is not basing any recommendation on materially inaccurate or incomplete information; and
- Have a reasonable basis for:
    - any advice provided to or on behalf of a client;
    - any representations made in a certificate that it signs that will be reasonably foreseeably relied upon by the client, any other party involved in the municipal securities transaction or municipal financial product, or investors in the municipal entity client's securities or securities secured by payments from an obligated person client; and
    - any information provided to the client or other parties involved in the municipal securities transaction in connection with the preparation of an official statement for any issue of municipal securities as to which the advisor is advising.

The duty of care, which is applicable to all municipal advisory activities regardless of the type of client, also applies to the provision of comments following the review of any document and the provision of language for use in any document—including an official statement—to the extent that conduct constitutes municipal advisory activity.

Duty of Loyalty. The duty of loyalty includes, but is not limited to, the specific obligations set forth in SM .02. Under SM .02, the duty of loyalty:

- Requires a municipal advisor, when engaging in municipal advisory activities for a municipal entity client, to deal honestly and with the utmost good faith with the municipal entity and act in its best interests without regard to the financial or other interests of the municipal advisor; and
- Precludes a municipal advisor from engaging in municipal advisory activities with a municipal entity client if it cannot manage or mitigate its conflicts of interest in a manner that will permit it to act in the municipal entity's best interests.

Action Independent of or Contrary to Advice. SM. 03 provides that a municipal advisor is not required to disengage from a municipal advisory relationship if a municipal entity client or an obligated person client elects a course of action that is independent of, or contrary to, the municipal advisor's advice.

Limitations on the Scope of the Engagement. SM .04 specifies that a municipal advisor may limit the scope of the municipal advisory activities to be performed to certain specified activities or services if requested or expressly consented to by the municipal entity or obligated person client. However, the municipal advisor cannot alter the standards of conduct or impose limitations on any of the duties (*e.g.*, duty of care or duty of loyalty) prescribed by Rule G-42. In addition, if a municipal advisor engages in a course of conduct that is inconsistent with the agreed upon limitations on the scope of the engagement, such conduct may result in negating the effectiveness of any limitations on the scope of the engagement.

Disclosure of Conflicts of Interest and Other Information — Rule G-42(b)
Section (b) of Rule G-42 requires a municipal advisor to fully and fairly disclose to its municipal entity or obligated person client, in writing, all material conflicts of interest, including, but not limited to, those conflicts of interest specifically described in section (b), and any legal or disciplinary event that is material to the client's evaluation of the municipal advisor or the integrity of its management or advisory personnel. These disclosures must be provided by the municipal advisor prior to or upon engaging in

municipal advisory activities for or on behalf of the municipal entity or obligated person.

Rule G-42(b)(i), setting forth a non-exhaustive list of scenarios under which a material conflict of interest is always deemed to exist, requires the disclosure of:

- Any affiliate of the municipal advisor that provides any advice, service or product to or on behalf of the client that is directly related to the municipal advisory activities to be performed by the disclosing municipal advisor;
- Any payments made by the municipal advisor, directly or indirectly, to obtain or retain an engagement to perform municipal advisory activities for the client;
- Any payments received by the municipal advisor from a third party to enlist the municipal advisor's recommendation to the client of its services, any municipal securities transaction or any municipal financial product;
- Any fee-splitting arrangements involving the municipal advisor and any provider of investments or services to the client; and
- Any conflicts of interest arising from compensation for municipal advisory activities to be performed that is contingent on the size or closing of any transaction as to which the municipal advisor is providing advice.

Under Rule G-42(b)(i)(F), a municipal advisor must disclose any other actual or potential conflicts of interest, of which a municipal advisor is aware, after reasonable inquiry, that could reasonably be anticipated to impair the municipal advisor's ability to provide advice to or on behalf of the client in accordance with the applicable standards of conduct of Rule G-42(a) (*i.e.*, the duty of care and/or the duty of loyalty).

If a municipal advisor concludes, based on the exercise of reasonable diligence, that it has no known material conflicts of interest, the municipal advisor must provide a written statement to the client to that effect.

Rule G-42(b)(ii) requires disclosure of any legal or disciplinary event that is material to the client's evaluation of the municipal advisor or the integrity of its management or advisory personnel. To facilitate the use of existing records, a municipal advisor may comply with such disclosure obligation by identifying the specific type of event and specifically referring the client to

the relevant portions of the municipal advisor's most recent SEC Forms MA or MA-I[12] filed with the SEC, if the municipal advisor provides detailed information specifying where the client may access such forms electronically. This approach using existing records is permissive, and a municipal advisor also may comply by creating the disclosures rather than referring to its filed SEC Forms MA or MA-I.

If a municipal advisor discloses such legal or disciplinary event by referring to the municipal advisor's most recent SEC Forms MA or MA-I, the mandated identification of the specific type of event and specific reference to the relevant portion of the municipal advisor's SEC Forms MA or MA-I may not be satisfied by a broad reference to the section of the forms containing such disclosures. Similarly, the requirement to provide "detailed information" specifying where the client may electronically access the SEC Forms MA and MA-I may not be satisfied by a general reference to the SEC's Electronic Data Gathering, Analysis, and Retrieval system ("EDGAR"). There may be several different approaches a municipal advisor may use to comply with the requirement to provide detailed information regarding where the client may access such forms. For example, a municipal advisor may comply with this portion of the requirements under Rule G-42(b)(ii) by publishing its most recent forms on its own website and then providing the client with the direct web link or internet address to the relevant form. Alternatively, if solely registered with the SEC as a municipal advisor, a municipal advisor could provide its client with a functioning Uniform Resource Locator ("URL") (also referred to as a web address or link) to the specific location on the EDGAR system where all company filings of the municipal advisor are found, which includes the municipal advisor's most recently filed Form MA or MA-I. These examples are only illustrative and do not preclude other methods of compliance.

Conflicts of Interest. SM .05 provides that the required conflicts of interest disclosures must be sufficiently detailed to inform the client of the nature, implications and potential consequences of each conflict and must include an explanation of how the municipal advisor addresses, or intends to manage or mitigate, each conflict. Coupled with its duty to disclose material conflicts of interest, a municipal advisor's obligation to explain how it addresses or intends to manage or mitigate its material conflicts of interest is included in Rule G-42 to reflect the MSRB's general intention to reduce the occurrence of material conflicts of interest and to require that all material conflicts of interest that occur be fully and fairly disclosed to the client and managed

[12] *See* 17 CFR 249.1300 (SEC Form MA); 17 CFR 249.1310 (SEC Form MA-I).

appropriately. Although the MSRB does not intend to prohibit all material conflicts of interest under Rule G-42, if not properly managed or mitigated, material conflicts of interest that might result in a municipal advisor providing advice that is not disinterested or suggesting a course of action without making a reasonable inquiry could lead to a failure to protect a municipal advisor's client's interest, thereby causing a breach of the duty of care and/or duty of loyalty that is established by section (a).

Inadvertent Advice. SM .07 provides that a municipal advisor that inadvertently engages in municipal advisory activities for a municipal entity or obligated person but does not intend to continue the municipal advisory activities or enter into a municipal advisory relationship is not required to comply with section (b), on disclosures of conflicts of interest, and section (c), on documentation of the municipal advisory relationship, if the municipal advisor meets several specified requirements. Those requirements are set forth in SM .07, including the requirement that the municipal advisor provide, as promptly as possible after discovery of the provision of inadvertent advice, a document to the municipal entity or obligated person client that is dated and includes:

- A disclaimer that the municipal advisor did not intend to provide advice and that, effective immediately, the municipal advisor has ceased engaging in municipal advisory activities with respect to that municipal entity or obligated person client in regard to all transactions and municipal financial products as to which advice was inadvertently provided;
- A notification that the municipal entity or obligated person client should be aware that the municipal advisor has not provided the disclosure of material conflicts of interest and other information required by section (b);
- An identification of all of the advice that was inadvertently provided, based on a reasonable investigation; and
- A request that the municipal entity or obligated person acknowledge receipt of the document.

The municipal advisor also is required to conduct promptly a review of its written supervisory and compliance policies and procedures to ensure that they are reasonably designed to prevent inadvertently providing advice to municipal entities and obligated persons.

The final sentence of SM .07 emphasizes that the satisfaction of the requirements of SM .07 has no effect on the applicability of any provisions of Rule G-42 other than sections (b) and (c). If SM .07 were to relieve advisors from compliance with other provisions of Rule G-42, SM .07 might be

misinterpreted or misused in a manner contrary to the purposes of the SEC's registration regime and the fiduciary duty owed to municipal entity clients. The final sentence also emphasizes that the satisfaction of the requirements of SM .07 has no effect on the applicability of any other legal requirements applicable to municipal advisory activities, which may include, but would not be limited to, other MSRB rules (including Rule G-23), Financial Industry Regulatory Authority ("FINRA") rules or federal or state laws.

Applicability of State or Other Laws and Rules. SM .08 states, as a general matter, that municipal advisors may be subject to fiduciary or other duties under state or other laws and nothing in Rule G-42 would supersede any more restrictive provision of state or other laws applicable to municipal advisory activities. SM .08 also provides an exception to the ban on principal transactions in subsection (e)(ii) in order to avoid a possible conflict with existing MSRB Rule G-23, on activities of financial advisors.

Documentation of Municipal Advisory Relationship — Rule G-42(c)
Section (c) of Rule G-42 requires each municipal advisor to evidence each of its municipal advisory relationships by a writing or writings created and delivered to the municipal entity or obligated person client prior to, upon or promptly after the establishment of the municipal advisory relationship.

The documentation must be dated and include, at a minimum:

- The form and basis of direct or indirect compensation, if any, for the municipal advisory activities to be performed;
- The information that must be disclosed in section (b), regarding the disclosures of conflicts of interest and other information;
- A description of the specific type of information regarding legal and disciplinary events requested by SEC Forms MA and MA-I, and detailed information specifying where the client may electronically access the municipal advisor's most recent Form MA and each most recent Form MA-I filed with the SEC;
- The date of the last material change or addition to the legal or disciplinary event disclosures on any SEC Forms MA or MA-I filed with the SEC by the municipal advisor and a brief explanation of the basis for the materiality of the change or addition;
- The scope of the municipal advisory activities to be performed and any limitations on the scope of the engagement;
- The date, triggering event, or means for the termination of the municipal advisory relationship, or, if none, a statement that there is none; and

- Any terms relating to withdrawal from the municipal advisory relationship.

Municipal advisors have the option of complying with the requirements of Rule G-42(c)(ii) (and Rule G-42(b)), to disclose any legal or disciplinary event that is material to the client's evaluation of the municipal advisor or the integrity of its management or advisory personnel by either: (1) identifying the specific type of event and specifically referring to the relevant portions of the municipal advisor's most recent Forms MA or MA-I (and, if doing so, providing detailed information specifying where the client may electronically access such forms), or (2) providing its client a writing that fully and fairly discloses the information required to be disclosed under Rule G-42(c)(ii) and (b). In addition, to provide additional flexibility and help avoid duplicative disclosures, under SM .06, a municipal advisor need not make the disclosure of conflicts of interest and other information required under subsection (c)(ii) if the municipal advisor previously fully complied with the requirements of section (b) to disclose conflicts of interest and other information and subsection (c)(ii) does not require the disclosure of any materially different information than that previously disclosed to the client.

Rule G-42(c)(iv), which requires the municipal advisor to provide its clients with a brief explanation of the basis for the materiality of the change or addition to its Forms MA and MA-I, allows a client to assess the effect that such change or addition may have on the municipal advisory relationship and evaluate whether it should seek or review additional information.

Section (c) does not require that the writing(s) evidencing the relationship be a bilateral agreement or contract. For example, if state law provides for the procurement of municipal advisory services in a manner that does not require a writing sufficient to establish a bilateral agreement, a municipal advisor may send its client a writing, such as a letter that references the procurement document and contains the terms and disclosures required by Rule G-42(b) and (c) to evidence its municipal advisory relationship with its municipal entity or obligated person client.

SM .06 requires municipal advisors to promptly amend or supplement the writing(s) during the term of the municipal advisory relationship as necessary to reflect any material changes or additions in the required information. For example, if the basis of compensation or scope of services materially changes during the term of the relationship, the municipal advisor is required to amend or supplement the writing(s) and promptly deliver the amended writing(s) or supplement to the client. The same is true in the case of material conflicts of interest discovered after the relationship documentation was last provided to the client. The amendment and supplementation

requirement in section (c) applies to any material changes and additions that are discovered, or should have been discovered, based on the exercise of reasonable diligence by the municipal advisor. Any amendments or supplementations also are subject to the requirements of Rule G-42 as if such amendments or supplementations were the first relationship documentation provided to the client.

Recommendations and Review of Recommendations of Other Parties — Rule G-42(d)

Rule G-42(d) provides that "[i]f a municipal advisor makes a recommendation of a municipal securities transaction or municipal financial product to a municipal entity or obligated person client, it must have a reasonable basis to believe that the recommended municipal securities transaction or municipal financial product is suitable for the client, based on the information obtained through the reasonable diligence of the municipal advisor."[13] Section (d) also contemplates that a municipal advisor may be requested by the client to review and determine the suitability of a recommendation made by a third party to the client. Rule G-42(d) therefore provides that if the municipal advisor's "review of a recommendation of another party is requested by the municipal entity or obligated person client and within the scope of the engagement, the municipal advisor must determine, based on the information obtained through the reasonable diligence of such municipal advisor, whether the municipal securities transaction or municipal financial product is or is not suitable for the client."

As to both types of review, the municipal advisor is required under section (d) to inform its municipal entity or obligated person client of:

- Its evaluation of the material risks, potential benefits, structure and other characteristics of the recommended municipal securities transaction or municipal financial product;

[13] Some securities market participants are required to make only recommendations that are "consistent with" their customer's best interests. (*See* FINRA Notice 12-25, Suitability (May 2012)). As provided in section (a) and SM .02, a municipal advisor to a municipal entity client owes the client a fiduciary duty that includes a duty of loyalty in addition to the duty of care, which requires the municipal advisor to deal honestly and with the utmost good faith with the municipal entity client and act in the client's best interests without regard to the financial or other interests of the municipal advisor. A municipal advisor's recommendations of municipal securities transactions and municipal financial products to a municipal entity client, as is the case with all municipal advisory activities performed for a municipal entity client, must comport with the municipal advisor's fiduciary duty and particularly its duty of loyalty. The MSRB considers the duty of loyalty described in Rule G-42 to be even more rigorous than a standard requiring consistency with a client's best interests.

- The basis upon which the advisor reasonably believes the recommended transaction or product is, or, in the case of review of a recommendation of another party, is or is not, suitable for the client; and
- Whether the municipal advisor has investigated or considered other reasonably feasible alternatives to the recommended municipal securities transaction or municipal financial product that might also or alternatively serve the client's objectives.

Rule G-42 does not include requirements regarding how such information must be communicated by the municipal advisor to the client, and a municipal advisor is permitted to choose an appropriate method by which to communicate the information to its client so long as it comports with the duty of care and, if applicable, duty of loyalty owed.

The design of section (d), like other provisions of Rule G-42, is influenced by the basic principle that the client should control the scope of the engagement with its municipal advisor (with the agreement of the municipal advisor). A municipal advisor's engagement may be limited in scope because, for example, the municipal advisor's client already reached a decision regarding a particular municipal securities transaction or municipal financial product, or engaged another professional to undertake certain duties in connection with a municipal securities transaction or municipal financial product. However, as discussed above, a municipal advisor is not permitted to alter the standards of conduct or duties imposed by Rule G-42 with respect to the limited scope of the municipal advisory activities to be performed.

Rule G-42 also adopts, and applies to municipal advisors, the existing MSRB interpretive guidance regarding the general principles currently applicable to dealers for determining whether a particular communication constitutes a recommendation of a securities transaction.[14] Accordingly, a municipal advisor's communication to its client that could reasonably be viewed as a "call to action" to engage in a municipal securities transaction or enter into a municipal financial product is considered a recommendation and obligates the municipal advisor to conduct a suitability analysis of its recommendation. Communications by a municipal advisor to a client that concern minor or ancillary matters that relate to, but are not recommendations of, a municipal

[14] *See* MSRB Rule G-19. *See also* MSRB Notice 2002-30 (Sept. 25, 2002) Notice Regarding Application of Rule G-19, on Suitability of Recommendations and Transactions, to Online Communications, available at: http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2002/2002-30.aspx?n=1.

securities transaction or municipal financial product may constitute advice (and therefore trigger other provisions of the rule) but would not trigger the suitability obligation in section (d).

Non-Exhaustive List of Factors for Determining Suitability. SM .09 provides guidance related to a municipal advisor's suitability obligations. Under this provision, a municipal advisor's determination of whether a municipal securities transaction or municipal financial product is suitable for its client must be based on numerous factors, as applicable to the particular type of client, including, but not limited to, the client's:

- Financial situation and needs;
- Objectives;
- Tax status;
- Risk tolerance;
- Liquidity needs;
- Experience with municipal securities transactions or municipal financial products generally or of the type and complexity being recommended;
- Financial capacity to withstand changes in market conditions during the term of the municipal financial product or the period that municipal securities to be issued are reasonably expected to be outstanding; and
- Any other material information known by the municipal advisor about the client and the municipal securities transaction or municipal financial product, after a reasonable inquiry.

Know Your Client. In regard to the maintenance of the municipal advisory relationship, SM .10 requires a municipal advisor to know its client. To fulfill this obligation, the municipal advisor must use reasonable diligence to know and retain essential facts concerning the client and concerning the authority of each person acting on behalf of the client, and is similar to analogous requirements in other regulatory regimes. The facts "essential" to knowing one's client include those required to effectively service the municipal advisory relationship with the client; act in accordance with any special directions from the client; understand the authority of each person acting on behalf of the client; and comply with applicable laws, rules and regulations. Although distinct from a municipal advisor's suitability obligation under section (d), this know-your-client obligation and the suitability obligation are highly inter-related, as SM .09 requires a municipal advisor to take into account its knowledge of the client when conducting a suitability analysis.

Subsection (d)(iii) requires a municipal advisor to inform its client whether or not it investigated or considered other reasonably feasible alternatives to the recommendation it made to its client that might also or alternatively serve the client's objectives. This language does not require a municipal advisor to provide its client with an exhaustive list of "alternative financings" together with its recommendation (particularly if such alternative financings are not germane to the client), nor does it require the municipal advisor to conduct a suitability analysis on any "reasonably feasible alternative" considered or investigated by the municipal advisor. The municipal advisor is obligated under subsection (d)(iii) only to inform its client whether or not it considered or investigated reasonably feasible alternatives. The decision whether to have the municipal advisor discuss the alternatives it considered or investigated is left to the discretion of the municipal advisor and its client and their determination together of the scope of the municipal advisory engagement.

Section (d) requires a municipal advisor to have a reasonable basis to believe that its recommended municipal securities transaction or municipal financial product is suitable for its municipal entity or obligated person client. A municipal advisor also must have a reasonable basis for determining whether a recommendation, which was made by another party and the municipal advisor is reviewing, is or is not suitable for the municipal entity or obligated person client. In both instances, a municipal advisor must exercise reasonable diligence to obtain the information that enables the municipal advisor to have a reasonable basis for its suitability determination. SM .01 further requires a municipal advisor to undertake a reasonable investigation to determine that it is not basing any recommendation on materially inaccurate or incomplete information. As the MSRB previously stated, if the information necessary to determine whether a municipal advisor is basing its recommendation on materially inaccurate or incomplete information is non-public, entirely created or controlled by the client or is not otherwise accessible through a reasonable amount of effort by the municipal advisor, then, in such instances, the determination of what would constitute a reasonable investigation would be reflective of those and other relevant facts and circumstances.[15]

Recordkeeping Requirements for Recommendations and Reviews of Recommendations — Amended Rule G-8(h)(iv). Amended Rule G-8(h)(iv) requires each municipal advisor to make and keep a copy of any document created by the municipal advisor that was material to its review of a

[15] *See*, *e.g.*, MSRB's First Response to Comments.

recommendation by another party or that memorializes the basis for any determination as to suitability. As discussed above, only certain communications between a municipal advisor and its client constitute recommendations of a municipal securities transaction or municipal financial product and others constitute advice. Only the former triggers a suitability determination under Rule G-42 and only those communications will trigger the requirement of Rule G-8(h)(iv) regarding memorialized bases for suitability determinations.

Specified Prohibitions — Rule G-42(e)(i)

Subsection (e)(i) of Rule G-42 prohibits discrete conduct or activities that conflict, or would be highly likely to conflict, with the core standards of conduct with which municipal advisors must comply under Rule G-42 and the Exchange Act.

Excessive Compensation. Paragraph (e)(i)(A) prohibits a municipal advisor from receiving compensation from its client that is excessive in relation to the municipal advisory activities actually performed for the client. SM .11 provides several factors that may be relevant in assessing whether the compensation of a municipal advisor is so disproportionate to the nature of the municipal advisory activities performed as to be excessive, including:

- The municipal advisor's expertise;
- The complexity of the municipal securities transaction or municipal financial product;
- Whether the fee is contingent upon the closing of the municipal securities transaction or municipal financial product;
- The length of time spent on the engagement, and;
- Whether the municipal advisor is paying any other relevant costs related to the municipal securities transaction or municipal financial product.

The factors included in SM .11 are non-exhaustive and other factors relevant under the particular facts and circumstances should also be considered.

Inaccurate Invoices. Paragraph (e)(i)(B) prohibits municipal advisors from delivering an invoice for fees or expenses for municipal advisory activities that is materially inaccurate in its reflection of the activities actually performed or the personnel that actually performed those activities. The provision does not prohibit a municipal advisor from including a discount for the services it actually performed, if accurately disclosed. The prohibition is intended to target material inaccuracies on the significant subjects of the services performed and the personnel who performed those services.

False or Materially Misleading Representations. Paragraph (e)(i)(C) prohibits a municipal advisor from making representations or submitting information that the municipal advisor knows, or should know, is materially false or misleading, with respect to the municipal advisor's capacity, resources or knowledge to a client or prospective client, for the purpose of obtaining or retaining an engagement to perform municipal advisory activities. In addition, the MSRB's existing fundamental fair practice rule, MSRB Rule G-17, on conduct of municipal securities and municipal advisory activities, prohibits municipal advisors, in the conduct of their municipal advisory activities, from engaging in any deceptive, dishonest or unfair practice with any person.

Fee-Splitting Arrangements. Paragraph (e)(i)(D) prohibits municipal advisors from making, or participating in, two types of fee-splitting arrangements: (1) any fee-splitting arrangement with an underwriter on any municipal securities transaction as to which the municipal advisor has provided or is providing advice and (2) any undisclosed fee-splitting arrangement with providers of investments or services to a municipal entity or obligated person client of the municipal advisor.

Payments for Obtaining/Retaining Municipal Advisory Business. Paragraph (e)(i)(E) generally prohibits a municipal advisor from making payments for the purpose of obtaining or retaining an engagement to perform municipal advisory activities, with three exceptions. The prohibition does not apply to payments to an affiliate of the municipal advisor for a direct or indirect communication with a municipal entity or obligated person on behalf of the municipal advisor where such communication is made for the purpose of obtaining or retaining an engagement to perform municipal advisory activities. This exception is aligned with Section 15B(e)(9) of the Exchange Act, which allows affiliates of a municipal advisor to solicit on behalf of the municipal advisor without triggering the municipal advisor registration requirement for the affiliates.[16] The prohibition also does not apply to: reasonable fees paid to another municipal advisor registered as such with the SEC and MSRB for making such communications for the purpose of obtaining or retaining an engagement to perform municipal advisory activities, because, as a registered municipal advisor, the entity is specifically regulated with respect to its engagement in such solicitation conduct. Finally, the prohibition does not apply to payments that are permissible "normal business dealings" as described in MSRB Rule G-20, on gifts, gratuities and non-cash compensation, because the MSRB believes that such payments,

[16] *See* Section 15B(e)(9) of the Exchange Act, 15 U.S.C. 78o-4(e)(9).

which are already regulated under MSRB Rule G-20, do not raise concerns regarding conflicts of interest that are sufficient to warrant a specific prohibition.

Ban on Principal Transactions — Rule G-42(e)(ii)

Ban on Certain Principal Transactions. Subsection (e)(ii) of Rule G-42 prohibits a municipal advisor, and any affiliate of such municipal advisor, from engaging with a municipal entity client in a principal transaction that is the same, or directly related to the, issue of municipal securities or municipal financial product as to which the municipal advisor is providing or has provided advice to the municipal entity client (the "ban on principal transactions" or "ban"). This specified prohibition applies only with respect to clients that are municipal entities, and does not apply to principal transactions between a municipal advisor (or an affiliate of the municipal advisor) and the municipal advisor's obligated person clients. Importantly, however, all municipal advisors, including those engaging in municipal advisory activities for obligated person clients, are subject to the MSRB's fundamental fair-practice rule, Rule G-17.

For purposes of the ban in Rule G-42(e)(ii), the term "principal transaction" is defined in Rule G-42(f)(ix) to mean "when acting as principal for one's own account, a sale to or a purchase from the municipal entity client of any security or entrance into any derivative, guaranteed investment contract, or other similar financial product with the municipal entity client." This definition is designed, in part, to exclude transactions such as the taking of a cash deposit or the making of a payment by a client solely for professional services. Further, SM .13 clarifies that the term "other similar financial product," for purposes of the defined term "principal transaction" in Rule G-42(f)(ix), includes a bank loan but only if it is in an aggregate principal amount of $1,000,000 or more and is economically equivalent to the purchase of one or more municipal securities. Bank loans are included under the specified circumstances because, as a matter of market practice, they serve as a financing alternative to the issuance of municipal securities and pose a comparable potential for self-dealing and other breaches of the fiduciary duty owed by a municipal advisor to its municipal entity client.

Applicability of Other MSRB Rules. In order to avoid a possible conflict with MSRB Rule G-23, on activities of financial advisors, SM .08 states that the ban in subsection (e)(ii) does not apply to an acquisition as principal, either alone or as a participant in a syndicate or other similar account formed for the purpose of purchasing, directly or indirectly, from an issuer all or any portion of an issuance of municipal securities on the basis that the municipal advisor provided advice as to the issuance, because such a transaction is the type of transaction that is addressed, and, in certain circumstances, prohibited by

Rule G-23. This provision is quite limited, providing an exception only to the specific prohibition in subsection G-42(e)(ii). It does not mean, for example, that a transaction not prohibited by Rule G-23 is deemed in all cases to be lawful under all other requirements of Rule G-42 (such as the duty of loyalty owed to a municipal entity client) and other laws (such as the statutory fiduciary duty) and regulations.

Exception to the Ban on Principal Transactions. A narrow exception to the principal transaction ban in Rule G-42(e)(ii) (the "Exception") is set forth in SM .14. The Exception provides a municipal advisor with two options under which it is not specifically prohibited from engaging in principal transactions in certain fixed-income securities with a municipal entity client. Under the first option a municipal advisor must comply with sections (a) through (c) and subsection (d)(1) of SM .14, under which a municipal advisor may act, on a transaction-by-transaction basis, in accordance with a short set of procedural requirements.[17] Under the alternative option, a municipal advisor must comply with sections (a) through (c) and subsection (d)(2) of SM .14, which imposes more and different requirements, other than on a transaction-by-transaction basis, under paragraphs (d)(2)(A) through (F).[18] For example, these requirements include obtaining from the municipal entity client a prospective blanket written consent.

The Exception operates only to take certain conduct out of the specified ban on principal transactions in Rule G-42(e)(ii). It does not provide a safe harbor from complying with any other applicable law or rules. A municipal advisor engaging in a principal transaction in compliance with the Exception must continue to be mindful of, and comply with, its broader and foundational obligations owed to the municipal entity client as a fiduciary under the Exchange Act and Rule G-42, as well as all other applicable provisions of the federal securities laws and state law. Moreover, the Exception does not extend to affiliates of a municipal advisor.[19]

Requirements Applicable to All Users of the Exception. All the requirements for the Exception take the form of various conditions and limitations. Under

[17] Some of these procedural requirements are drawn from and similar to the requirements set forth in Section 206(3) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-6(3).

[18] These procedural requirements are drawn from and similar to those set forth in Investment Advisers Act Rule 206(3)-3T, 17 CFR 275.206(3)-3T.

[19] Various provisions make clear that the Exception does not apply to affiliates of a municipal advisor. *See*, *e.g.*, SM .14(d)(2)(B) and SM .14(d)(2)(C).

SM .14(a), a principal transaction may be excepted from the specified ban on principal transactions only if the municipal advisor also is a broker-dealer registered under Section 15 of the Exchange Act,[20] and each account for which the municipal advisor is relying on the Exception is a brokerage account subject to the Exchange Act, the rules thereunder, and the rules of the self-regulatory organization(s) of which the broker-dealer is a member. In addition, the municipal advisor may not exercise investment discretion with respect to the account, unless granted by the municipal entity client on a temporary or limited basis.[21]

Under SM .14(b), neither the municipal advisor nor any affiliate of the municipal advisor may be providing, or have provided, advice to the municipal entity client as to an issue of municipal securities or a municipal financial product that is directly related to the principal transaction, except advice as to another principal transaction that also meets all the other requirements of SM .14. For example, a municipal advisor may not use the Exception to reinvest proceeds from an issue of municipal securities where the municipal advisor also was the municipal advisor as to such issue. A municipal advisor may use the Exception, however, for two principal transactions with the same municipal entity client where the transactions are directly related to one another, so long as all of the conditions and limitations of the Exception are met as to each transaction. In addition, SM .14(b) does not restrict the use of the Exception by a municipal advisor that also is providing or has provided advice to the municipal entity client as to an issue of municipal securities or a municipal financial product that is directly related to the principal transaction, where such advisory activity is within an exclusion or exemption under Exchange Act Rule 15Ba1-1.[22] For example, a

---

[20] 15 U.S.C. 78o.

[21] As used in SM. 14 of Rule G-42, "investment discretion" has the same meaning as in Exchange Act Section 3(a)(35), 15 U.S.C. 78c(a)(35), which provides:

> A person exercises "investment discretion" with respect to an account if, directly or indirectly, such person (A) is authorized to determine what securities or other property shall be purchased or sold by or for the account, (B) makes decisions as to what securities or other property shall be purchased or sold by or for the account even though some other person may have responsibility for such investment decisions, or (C) otherwise exercises such influence with respect to the purchase and sale of securities or other property by or for the account as the Commission, by rule, determines, in the public interest or for the protection of investors, should be subject to the operation of the provisions of this chapter and the rules and regulations thereunder.

[22] *See* Exchange Act Rule 15Ba1-1, 17 CFR 240.15Ba1-1.

broker-dealer that has provided advice to a municipal entity within the underwriter exclusion with respect to an issuance of municipal securities would not be specifically prohibited from advising on and selling investments of the bond proceeds, as principal, assuming all of the limitations and conditions of the Exception are met.

SM .14(c) limits a municipal advisor's principal transactions under the Exception to sales to or purchases from a municipal entity client of any "U.S. Treasury security," "agency debt security" or "corporate debt security." These terms and related terms, "agency," "government-sponsored enterprise," "money market instrument" and "securitized product," are defined in SM .15 for purposes of both SM.14 and SM .15. The class of securities that may be traded pursuant to the Exception may be broader than what may be permitted by relevant bond documents or a particular municipal entity's investment policies, but, in such cases, the restrictions in the bond documents or the municipal entity's investment policies would control.

SM .14(c) also makes clear that the Exception is not available for transactions involving municipal escrow investments. For purposes of Rule G-42, the term "municipal escrow investments" is defined in Exchange Act Rule 15Ba1-1(h) to mean "proceeds of municipal securities and any other funds of a municipal entity that are deposited in an escrow account to pay the principal of, premium, if any, and interest on one or more issues of municipal securities." Municipal escrow investments often involve large sums for long periods of time linked to call restrictions or maturities of refunded debt, and are an area of heightened risk where, historically, significant abuses have occurred.

Additional Conditions Applicable to Principal Transactions Executed Using Subsection (d)(1) of SM .14. As noted above, the Exception provides a municipal advisor with two options under which the municipal advisor is not specifically prohibited from engaging in certain principal transactions with a municipal entity client, provided the municipal advisor also complies with the first three requirements set forth in SM. 14(a) through (c). The first of the two options is set forth in SM .14(d)(1) and the second is set forth in SM .14(d)(2).

Under SM .14(d)(1), a municipal advisor is required, on a transaction-by-transaction basis, to disclose to the municipal entity client in writing before the completion of the principal transaction the capacity in which the municipal advisor is acting and obtain the written or oral consent of the client to such transaction. Informed consent is required, and in order to make informed consent, the municipal advisor, consistent with its fiduciary duty, is required to disclose specified information, including the price and

other terms of the transaction, as well as the capacity in which the municipal advisor would be acting. "Before completion" means either prior to execution of the transaction, or after execution but prior to settlement.

Additional Conditions Applicable to Principal Transactions Executed Using Subsection (d)(2) of SM .14. Under SM .14(d)(2), a municipal advisor may comply with SM .14(d) by meeting six requirements, as set forth in SM .14(d)(2)(A) through (F), as follows:

- Under SM .14(d)(2)(A), neither the municipal advisor nor any of its affiliates may be the issuer, or the underwriter of a security that is the subject of the principal transaction;

- Under SM .14(d)(2)(B), the municipal advisor must obtain from the municipal entity client an executed written, revocable consent that prospectively authorizes the municipal advisor directly or indirectly to act as principal for its own account in selling a security to or purchasing a security from the municipal entity client, so long as such written consent is obtained after written disclosure is made to the municipal entity client explaining:
    - the circumstances under which the municipal advisor directly or indirectly may engage in principal transactions;
    - the nature and significance of conflicts with the municipal entity client's interests as a result of the transactions; and
    - how the municipal advisor addresses those conflicts;

- Under SM .14(d)(2)(C), the municipal advisor, prior to the execution of each principal transaction, must:
    - inform the municipal entity client, orally or in writing, of the capacity in which it may act with respect to such transaction and
    - obtain consent from the municipal entity client, orally or in writing, to act as principal for its own account with respect to such transaction;

- Under SM .14(d)(2)(D), the municipal advisor must send a written confirmation at or before completion of each principal transaction that includes the information required by Exchange Act Rule 10b-10 or MSRB Rule G-15, which both establish information requirements in the confirmation of transaction to customers, and a conspicuous, plain English statement informing the municipal entity client that the municipal advisor:

- disclosed to the client prior to the execution of the transaction that the municipal advisor may be acting in a principal capacity in connection with the transaction and the client authorized the transaction and
- sold the security to, or bought the security from, the client for its own account;

- Under SM .14(d)(2)(E), a municipal advisor must send its municipal entity client, no less frequently than annually, written disclosure containing a list of all transactions that were executed in the client's account in reliance upon this Exception, and the date and price of the transactions; and

- Under SM .14(d)(2)(F), each written disclosure must include a conspicuous, plain English statement regarding the ability of the municipal entity client to revoke the prospective written consent to principal transactions without penalty at any time by written notice.

A municipal advisor's use and compliance with the requirements of the Exception is not construed as relieving it in any way from acting in the best interests of its municipal entity client nor from any obligation that may be imposed by the Exchange Act, other provisions of Rule G-42 (other than subsection (e)(ii) of the rule), or other applicable provisions of the federal securities laws and state law. Additionally, the communications with customers described above that are required to be made in writing under the Exception may be made, as with similar requirements under in Section 206(3) of the Advisers Act and Rule 206(3)-T applicable to investment advisers, through email, provided the municipal advisor satisfies the same procedural conditions that the SEC applies to an investment adviser when communicating with customers through email.[23]

Definitions — Rule G-42(f)

The terms "advice," "affiliate of the municipal advisor," "municipal advisor," "municipal advisory activities," "municipal advisory relationship," "municipal entity," "obligated person," "official statement" and "principal transaction" are defined in Rule G-42(f). The terms, "advice," "municipal advisor," "municipal advisory activities, "municipal entity," and "obligated person,"

[23] *See* Securities Act of 1933 Release No. 7288 (May 9, 1996), 61 FR 24644 (May 15, 1996), SEC Interpretation of Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; available at: https://www.sec.gov/rules/interp/33-7288.txt.

were previously defined in the Exchange Act or in SEC rules, and the MSRB has incorporated by reference such definitions for purposes of Rule G-42. Further, as previously discussed, SM .13 provides guidance regarding instruments that may be "other similar financial products" for purposes of the definition of a "principal transaction."

Applicability of Rule G-42 to 529 College Savings Plans and Other Municipal Fund Securities — SM .12

The regulation of municipal advisors, as the SEC has recognized, is relevant to municipal fund securities.[24] SM .12 makes clear that Rule G-42 applies to municipal advisors whose municipal advisory clients are sponsors or trustees of municipal fund securities, including the sponsors or trustees of 529 college savings plans.

Amendments to Rule G-8

Amended Rule G-8(h)(iv) requires each municipal advisor to make and keep a copy of any document created by the municipal advisor that was material to its review of a recommendation by another party or that memorialize its basis for any conclusions as to suitability. This amendment is discussed in greater detail above in the context of Rule G-42(d), which sets forth specific requirements regarding the making of recommendations.

January 13, 2016

* * * * *

Text of Rule G-42 and Related Amendments to Rule G-8*

Rule G-42: Duties of Non-Solicitor Municipal Advisors

(a) *Standards of Conduct*.

(i) A municipal advisor to an obligated person client shall, in the conduct of all municipal advisory activities for that client, be subject to a duty of care.

[24] *See* Registration of Municipal Advisors, Exchange Act Release No. 70462 (September 20, 2013), 78 FR 67467, at 67473 (November 12, 2013) ("529 Savings Plans are also relevant in the context of municipal advisor regulation, because an issuance of interests in 529 Savings Plans is an issuance of municipal securities.").

* Underlining indicates new language.

(ii) A municipal advisor to a municipal entity client shall, in the conduct of all municipal advisory activities for that client, be subject to a fiduciary duty that includes a duty of loyalty and a duty of care.

(b) *Disclosure of Conflicts of Interest and Other Information*. A municipal advisor must, prior to or upon engaging in municipal advisory activities, provide to the municipal entity or obligated person client full and fair disclosure in writing of:

(i) all material conflicts of interest, including:

(A) any affiliate of the municipal advisor that provides any advice, service, or product to or on behalf of the client that is directly related to the municipal advisory activities to be performed by the disclosing municipal advisor;

(B) any payments made by the municipal advisor, directly or indirectly, to obtain or retain an engagement to perform municipal advisory activities for the client;

(C) any payments received by the municipal advisor from a third party to enlist the municipal advisor's recommendation to the client of its services, any municipal securities transaction or any municipal financial product;

(D) any fee-splitting arrangements involving the municipal advisor and any provider of investments or services to the client;

(E) any conflicts of interest arising from compensation for municipal advisory activities to be performed that is contingent on the size or closing of any transaction as to which the municipal advisor is providing advice; and

(F) any other actual or potential conflicts of interest, of which the municipal advisor is aware after reasonable inquiry, that could reasonably be anticipated to impair the municipal advisor's ability to provide advice to or on behalf of the client in accordance with the standards of conduct of section (a) of this rule, as applicable.

If a municipal advisor concludes that it has no known material conflicts of interest based on the exercise of reasonable diligence by the municipal advisor, the municipal advisor must provide a written statement to the client to that effect.

(ii) any legal or disciplinary event that is material to the client's evaluation of the municipal advisor or the integrity of its management or advisory personnel.
Information regarding legal or disciplinary events may be disclosed for purposes of this subsection by identification of the specific type of event and specific reference to the relevant portions of the municipal advisor's most recent Forms MA or MA-I filed with the Commission if the municipal advisor provides detailed information specifying where the client may electronically access such forms.

(c) *Documentation of Municipal Advisory Relationship*. A municipal advisor must evidence each of its municipal advisory relationships by a writing or writings created and delivered to the municipal entity or obligated person client prior to, upon or promptly after the establishment of the municipal advisory relationship. The writing(s) must be dated and include, at a minimum,

(i) the form and basis of direct or indirect compensation, if any, for the municipal advisory activities to be performed;

(ii) the information required to be disclosed by section (b) of this rule;

(iii) a description of the specific type of information regarding legal and disciplinary events requested by the Commission on Form MA and Form MA-I, which includes information about any criminal actions, regulatory actions, investigations, terminations, judgments, liens, civil judicial actions, customer complaints, arbitrations and civil litigation, and detailed information specifying where the client may electronically access the municipal advisor's most recent Form MA and each most recent Form MA-I filed with the Commission;

(iv) the date of the last material change or addition to the legal or disciplinary event disclosures on any Form MA or Form MA-I filed with the Commission by the municipal advisor and a brief explanation of the basis for the materiality of the change or addition;

(v) the scope of the municipal advisory activities to be performed and any limitations on the scope of the engagement;

(vi) the date, triggering event, or means for the termination of the municipal advisory relationship, or, if none, a statement that there is none; and

(vii) any terms relating to withdrawal from the municipal advisory relationship.

(d) *Recommendations and Review of Recommendations of Other Parties*. If a municipal advisor makes a recommendation of a municipal securities transaction or municipal financial product to a municipal entity or obligated person client, it must have a reasonable basis to believe that the recommended municipal securities transaction or municipal financial product is suitable for the client, based on the information obtained through the reasonable diligence of the municipal advisor. If the review of a recommendation of another party is requested by the municipal entity or obligated person client and within the scope of the engagement, the municipal advisor must determine, based on the information obtained through the reasonable diligence of such municipal advisor, whether the municipal securities transaction or municipal financial product is or is not suitable for the client. In addition, the municipal advisor must inform the client of:

(i) the municipal advisor's evaluation of the material risks, potential benefits, structure, and other characteristics of the recommended municipal securities transaction or municipal financial product;

(ii) the basis upon which the municipal advisor reasonably believes that the recommended municipal securities transaction or municipal financial product is, or (as may be applicable in the case of a review of a recommendation) is not, suitable for the client; and

(iii) whether the municipal advisor has investigated or considered other reasonably feasible alternatives to the recommended municipal securities transaction or municipal financial product that might also or alternatively serve the client's objectives.

(e) *Specified Prohibitions*.

(i) A municipal advisor is prohibited from:

(A) receiving compensation that is excessive in relation to the municipal advisory activities actually performed;

(B) delivering an invoice for fees or expenses for municipal advisory activities that is materially inaccurate in its reflection of the activities actually performed or the personnel that actually performed those activities;

(C) making any representation or the submission of any information that the municipal advisor knows or should know is either materially false or materially misleading due to the omission of a material fact about the capacity, resources or knowledge of the municipal advisor, in response to requests for proposals or qualifications or in oral presentations to a client or prospective client, for the purpose of obtaining or retaining an engagement to perform municipal advisory activities;

(D) making, or participating in, any fee-splitting arrangement with underwriters on any municipal securities transaction as to which it has provided or is providing advice, and any undisclosed fee-splitting arrangements with providers of investments or services to a municipal entity or obligated person client of the municipal advisor; and

(E) making payments for the purpose of obtaining or retaining an engagement to perform municipal advisory activities other than: (1) payments to an affiliate of the municipal advisor for a direct or indirect communication with a municipal entity or obligated person on behalf of the municipal advisor where such communication is made for the purpose of obtaining or retaining an engagement to perform municipal advisory activities; (2) reasonable fees paid to another municipal advisor registered as such with the Commission and the Board for making such a communication as described in subparagraph (e)(i)(E)(1); and (3) payments that are permissible "normal business dealings" as described in Rule G-20.

(ii) Except as provided for in paragraph .14 of the Supplementary Material of this rule, a municipal advisor to a municipal entity client, and any affiliate of such municipal advisor, is prohibited from engaging with the municipal entity client in a principal transaction that is the same, or directly related

to the, issue of municipal securities or municipal financial product as to which the municipal advisor is providing or has provided advice to the municipal entity client.

(f) *Definitions*.

(i) "Advice" shall, for purposes of this rule, have the same meaning as in Section 15B(e)(4)(A)(i) of the Act, 17 CFR 240.15Ba1-1(d)(1)(ii) and other rules and regulations thereunder.

(ii) "Affiliate of the municipal advisor" shall mean, for purposes of this rule, any person directly or indirectly controlling, controlled by, or under common control with such municipal advisor.

(iii) "Municipal advisor" shall, for purposes of this rule, have the same meaning as in Section 15B(e)(4) of the Act, 17 CFR 240.15Ba1-1(d)(1)-(4) and other rules and regulations thereunder; provided that it shall exclude a person that is otherwise a municipal advisor solely based on activities within the meaning of Section 15B(e)(4)(A)(ii) of the Act and rules and regulations thereunder or any solicitation of a municipal entity or obligated person within the meaning of Section 15B(e)(9) of the Act and rules and regulations thereunder.

(iv) "Municipal advisory activities" shall, for purposes of this rule, mean those activities that would cause a person to be a municipal advisor as defined in subsection (f)(iv) of this rule.

(v) A "municipal advisory relationship" shall, for purposes of this rule, be deemed to exist when a municipal advisor enters into an agreement to engage in municipal advisory activities for a municipal entity or obligated person. The municipal advisory relationship shall be deemed to have ended on the date which is the earlier of (i) the date on which the municipal advisory relationship has terminated pursuant to the terms of the documentation of the municipal advisory relationship required in section (c) of this rule or (ii) the date on which the municipal advisor withdraws from the municipal advisory relationship.

(vi) "Municipal entity" shall, for purposes of this rule, have the same meaning as in Section 15B(e)(8) of the Act, 17 CFR 240.15Ba1-1(g) and other rules and regulations thereunder.

(vii) "Obligated person" shall, for purposes of this rule, have the same meaning as in Section 15B(e)(10) of the Act, 17 CFR 240.15Ba1-1(k) and other rules and regulations thereunder.

(viii) "Official statement" shall, for purposes of this rule, have the same meaning as in Rule G-32(d)(vii).

(ix) "Principal transaction" shall mean, for purposes of this rule, when acting as principal for one's own account, a sale to or a purchase from the municipal entity client of any security or entrance into any derivative, guaranteed investment contract, or other similar financial product with the municipal entity client.

---Supplementary Material:

.01 Duty of Care. Municipal advisors must exercise due care in performing their municipal advisory activities. The duty of care includes, but is not limited to, the obligations discussed in this paragraph .01. A municipal advisor must possess the degree of knowledge and expertise needed to provide the municipal entity or obligated person client with informed advice. A municipal advisor also must make a reasonable inquiry as to the facts that are relevant to a client's determination as to whether to proceed with a course of action or that form the basis for any advice provided to the client. A municipal advisor must undertake a reasonable investigation to determine that it is not basing any recommendation on materially inaccurate or incomplete information. Among other matters, a municipal advisor must have a reasonable basis for:

(a) any advice provided to or on behalf of a client;

(b) any representations made in a certificate that it signs that will be reasonably foreseeably relied upon by the client, any other party involved in the municipal securities transaction or municipal financial product, or investors in the municipal entity client's securities or securities secured by payments from an obligated person client; and

(c) any information provided to the client or other parties involved in the municipal securities transaction in connection with the preparation of an official statement for any issue of municipal securities as to which the municipal advisor is advising.

.02 Duty of Loyalty. Municipal advisors must fulfill a duty of loyalty in performing their municipal advisory activities for municipal entity clients. The duty of loyalty includes, but is not limited to, the obligations discussed in this paragraph .02. A municipal advisor must deal honestly and with the utmost good faith with a municipal entity client and act in the client's best interests without regard to the financial or other interests of the municipal advisor. A municipal advisor must not engage in municipal advisory activities for a municipal entity client if it cannot manage or mitigate its conflicts of interest in a manner that will permit it to act in the municipal entity's best interests.

.03 Action Independent of or Contrary to Advice. If a municipal entity or obligated person client of a municipal advisor elects a course of action that is independent of or contrary to advice provided by the municipal advisor, the municipal advisor is not required on that basis to disengage from the municipal advisory relationship.

.04 Limitations on the Scope of the Engagement. Nothing contained in this rule shall be construed to permit the municipal advisor to alter the standards of conduct or impose limitations on any of the duties prescribed herein. If requested or expressly consented to by the municipal entity or obligated person client, however, a municipal advisor may limit the scope of the municipal advisory activities to be performed to certain specified activities or services. If the municipal advisor engages in a course of conduct that is inconsistent with any such agreed upon limitations, it may result in negating the effectiveness of such limitations.

.05 Conflicts of Interest. Disclosures of conflicts of interest by a municipal advisor to its municipal entity or obligated person client must be sufficiently detailed to inform the client of the nature, implications and potential consequences of each conflict. Such disclosures also must include an explanation of how the municipal advisor addresses or intends to manage or mitigate each conflict.

.06 Relationship Documentation. During the term of the municipal advisory relationship, the writing(s) required by section (c) of this rule must be promptly amended or supplemented to reflect any material changes or additions, and the amended writing(s) or supplement must be promptly delivered to the client. This amendment and supplementation requirement applies to any changes and additions that are discovered, or should have been discovered, based on the exercise of reasonable diligence by the municipal advisor. The information described in subsection (c)(ii) of this rule is not required if the municipal advisor previously fully complied with the requirements of section (b) of this rule to disclose conflicts of interest and other information and subsection (c)(ii) would not require the disclosure of any materially different information than that previously disclosed to the client.

.07 Inadvertent Advice. A municipal advisor is not required to comply with sections (b) and (c) of this rule if the municipal advisor meets all of the following requirements. In the event that a municipal advisor inadvertently engages in municipal advisory activities for a municipal entity or obligated person and does not intend to continue the municipal advisory activities or enter into a municipal advisory relationship, the municipal advisor must, as promptly as possible after discovery of the provision of inadvertent advice, provide a document to such municipal entity or obligated person that is dated and includes:

(a) a disclaimer that the municipal advisor did not intend to provide advice and that, effective immediately, it has ceased engaging in municipal advisory activities with respect to that municipal entity or obligated person in regard to all transactions and municipal financial products as to which advice was inadvertently provided;

(b) a notification that such municipal entity or obligated person should be aware that the disclosure of material conflicts of interest and other information required by section (b) of this rule has not been provided;

(c) an identification of all of the advice that was inadvertently provided, based on a reasonable investigation; and

(d) a request that the municipal entity or obligated person acknowledge receipt of the document.

A municipal advisor utilizing this alternative must promptly conduct a review of its written supervisory and compliance policies and procedures to ensure they are reasonably designed to prevent the provision of inadvertent advice to municipal entities and obligated persons. The use of this alternative has no effect on the applicability of any provisions of this rule other than sections (b) and (c) or any other legal requirements applicable to municipal advisory activities.

.08 Applicability of State or Other Laws and Rules. Municipal advisors may be subject to fiduciary or other duties under state or other laws. Nothing contained in this rule shall be deemed to supersede any more restrictive provision of state or other laws applicable to municipal advisory activities. In addition, the specific prohibition in subsection (e)(ii) of this rule shall not apply to an acquisition as principal, either alone or as a participant in a syndicate or other similar account formed for the purpose of purchasing, directly or indirectly, from an issuer all or any portion of an issuance of municipal securities on the basis that the municipal advisor provided advice as to the issuance because that is a type of transaction that is addressed and prohibited in certain circumstances by Rule G-23.

.09 Suitability. A determination of whether a municipal securities transaction or municipal financial product is suitable must be based on numerous factors, as applicable to the particular type of client, including, but not limited to, the client's financial situation and needs, objectives, tax status, risk tolerance, liquidity needs, experience with municipal securities transactions or municipal financial products generally or of the type and complexity being recommended, financial capacity to withstand changes in market conditions during the term of the municipal financial product or the period that municipal securities to be issued in the municipal securities transaction are reasonably expected to be outstanding and any other material information known by the municipal advisor about the client and the municipal securities transaction or municipal financial product, after reasonable inquiry.

.10 Know Your Client. A municipal advisor must use reasonable diligence, in regard to the maintenance of the municipal advisory relationship, to know and retain the essential facts concerning the client and concerning the authority of each person acting on behalf of such client. The facts "essential" to "knowing a client" include those required to:

(a) effectively service the municipal advisory relationship with the client;

(b) act in accordance with any special directions from the client;

(c) understand the authority of each person acting on behalf of the client; and

(d) comply with applicable laws, regulations and rules.

.11 Excessive Compensation. Depending on the specific facts and circumstances of the engagement, a municipal advisor's compensation may be so disproportionate to the nature of the municipal advisory activities performed as to constitute an unfair practice in violation of Rule G-17. Among the factors relevant to whether a municipal advisor's compensation is disproportionate to the nature of the municipal advisory activities performed are the municipal advisor's expertise, the complexity of the municipal securities transaction or municipal financial product, whether the fee is contingent upon the closing of the municipal securities transaction or municipal financial product, the length of time spent on the engagement and whether the municipal advisor is paying any other relevant costs related to the municipal securities transaction or municipal financial product.

.12 529 College Savings Plans and Other Municipal Fund Securities. This rule applies equally to municipal advisors to sponsors or trustees of 529 college savings plans and other municipal fund securities. All

references in this rule to an "official statement" include the plan disclosure document for a 529 college savings plan and the investment circular or information statement for a local government investment pool.

.13 Principal Transactions - Other Similar Financial Products. For purposes of subsection (f)(ix) of this rule, which defines the term "principal transaction," the phrase "other similar financial product" includes a bank loan, but only if it is in an aggregate principal amount of $1,000,000 or more and it is economically equivalent to the purchase of one or more municipal securities.

.14 Principal Transactions - Exception for Transactions in Specified Fixed Income Securities. Engaging in a principal transaction with a municipal entity client is not specifically prohibited under subsection (e)(ii) of this rule if:

(a) the municipal advisor is a broker-dealer registered under Section 15 of the Act, and each account as to which the municipal advisor relies on this paragraph .14 is a brokerage account subject to the Act, and the rules thereunder, and the rules of the self-regulatory organization(s) of which it is a member, and is an account as to which the municipal advisor exercises no investment discretion (as defined in Section 3(a)(35) of the Act), except investment discretion granted by a municipal entity client on a temporary or limited basis;

(b) neither the municipal advisor, nor any affiliate of the municipal advisor, is providing or has provided advice to the municipal entity client as to an issue of municipal securities or a municipal financial product that is directly related to the principal transaction (other than advice as to another principal transaction under circumstances meeting all the requirements of this paragraph .14);

(c) the principal transaction is a sale to or a purchase from the municipal entity client of any U.S. Treasury security, agency debt security, or corporate debt security (as defined in paragraph .15 of the Supplementary Material) and does not involve municipal escrow investments (as defined in 17 CFR 240.15Ba1-1(h)); and

(d) the municipal advisor either: (1) discloses to the municipal entity client in writing before the completion of the transaction the capacity in which the municipal advisor is acting and obtains the consent of the municipal entity client to such transaction or (2) executes the transaction under circumstances meeting all of the following requirements:

(A) neither the municipal advisor nor any of its affiliates are the issuer of, or, at the time of the sale, an underwriter (as defined in 17 CFR 240.15c2-12(f)(8)) of, the security;

(B) the municipal entity client has executed a written, revocable consent prospectively authorizing the municipal advisor directly or indirectly to act as principal for its own account in selling any security to or purchasing any security from the municipal entity client, so long as such written consent is obtained after written disclosure to the municipal entity client explaining: the circumstances under which the municipal advisor directly or indirectly may engage in principal transactions; the nature and significance of conflicts with its municipal entity client's interests as a result of the transactions; and how the municipal advisor addresses those conflicts;

(C) the municipal advisor, prior to the execution of each principal transaction, informs the municipal entity client, orally or in writing, of the capacity in which it may act with respect to such transaction and obtains consent from the municipal entity client, orally or in writing, to act as principal for its own account with respect to such transaction;

(D) the municipal advisor sends a written confirmation at or before completion of each such transaction that includes, in addition to the information required by 17 CFR 240.10b-10 or Rule G-15, a conspicuous, plain English statement informing the municipal entity client that the municipal advisor disclosed to the client prior to the execution of the transaction that the municipal advisor may be acting in a principal capacity in connection with the transaction, the municipal entity client authorized the transaction, and the municipal advisor sold the security to, or bought the security from, the municipal entity client for its own account;

(E) the municipal advisor sends to the municipal entity client, no less frequently than annually, written disclosure containing a list of all transactions that were executed in the client's account in reliance upon subsection (d)(2) of this paragraph .14, and the date and price of such transactions; and

(F) each written disclosure required by subsection (d)(2) of this paragraph .14 includes a conspicuous, plain English statement that the municipal entity client may revoke the written consent referred to in paragraph (d)(2)(B) of this paragraph .14 without penalty at any time by written notice to the municipal advisor.

This paragraph .14 shall not be construed as relieving in any way a municipal advisor from acting in the best interest of its municipal entity clients, nor shall it relieve the municipal advisor from any obligation that may be imposed by other applicable provisions of the federal securities laws and state law.

.15 Terms Relating to the Exception in Paragraph .14. For purposes of paragraph .14 and this paragraph .15 of the Supplementary Material:

(a) "agency" means a U.S. executive agency as defined in 5 U.S.C. 105 that is authorized to issue debt directly or through a related entity, such as a government corporation, or to guarantee the repayment of principal and/or interest of a debt security issued by another entity. The term excludes the U.S. Department of the Treasury in the exercise of its authority to issue U.S. Treasury securities;

(b) "agency debt security" means a debt security (i) issued or guaranteed by an agency, or (ii) issued or guaranteed by a government-sponsored enterprise, including a securitized product that is issued by an agency or a government-sponsored enterprise, or, for which, the principal or interest (or both) is guaranteed by an agency or a government-sponsored enterprise;

(c) "corporate debt security" means a debt security that is U.S. dollar-denominated and issued by a U.S. or foreign private issuer and, if a "restricted security" as defined in 17 CFR 230.144(a)(3), sold pursuant to 17 CFR 230.144A, but does not include a money market instrument;

(d) "government-sponsored enterprise" has the same meaning as defined in 2 U.S.C. 622(8);

(e) "money market instrument" means a debt security that at issuance has a maturity of one calendar year or less, or, if a discount note issued by an agency or a government-sponsored enterprise, a maturity of one calendar year and one day or less;

(f) "securitized product" means a security collateralized by any type of financial asset, such as a loan, a lease, a mortgage, or a secured or unsecured receivable, and includes, but is not limited to, an asset-backed security, a synthetic asset-backed security, and any residual tranche or interest of any security specified above, which tranche or interest is considered a debt security; and

(g) "U.S. Treasury security" means a security issued by the U.S. Department of the Treasury to fund the operations of the federal government or to retire such outstanding securities.

* * * * *

Rule G-8: Books and Records to be Made by Brokers, Dealers, Municipal Securities Dealers, and Municipal Advisors

(a) - (g) No change.

(h) *Municipal Advisor Records*. Every municipal advisor that is registered or required to be registered under Section 15B of the Act and the rules and regulations thereunder shall make and keep current the following books and records:

(i) No change.

(ii) Reserved.

(iii) Reserved.

(iv) *Records Concerning Duties of Non-Solicitor Municipal Advisors pursuant to Rule G-42*.

(A) A copy of any document created by a municipal advisor that was material to its review of a recommendation by another party or that memorializes the basis for any determination as to suitability.

(v) No change.