

## Municipal Securities

### FINRA Recommends Review of Municipal Securities Activities

#### Executive Summary

FINRA recommends that firms engaged in municipal securities business review and, if necessary, modify their policies and procedures in light of changes to the Municipal Securities Rulemaking Board's (MSRB) Electronic Municipal Market Access system (EMMA) that take effect July 1, 2009, and changes to MSRB rules that went into effect June 1, 2009.

FINRA also encourages firms to review the overall adequacy and effectiveness of their current policies and procedures for municipal securities activities generally, particularly those relating to the disclosure of material information, the suitability of recommendations to retail customers and the general supervision of their municipal securities activities.

Questions concerning this *Notice* should be directed to the Member Regulation Fixed Income Group at (202) 728-8085 or (202) 728-8133.

For information about compliance with MSRB rules, including the upcoming amendments to Rule 15c2-12, contact FINRA at the numbers above, or the MSRB at (703) 797-6600.

#### Background and Discussion

##### Municipal Securities Disclosure

Securities Exchange Act Rule 15c2-12 imposes certain obligations on municipal securities dealers in connection with disclosure, with both initial offerings and the secondary market.

#### June 2009

##### Notice Type

- Guidance

##### Suggested Routing

- Compliance
- Legal
- Municipal Securities
- Registered Representatives
- Senior Management

##### Key Topic(s)

- Disclosure
- EMMA
- Municipal Securities
- Suitability
- Supervision

##### Referenced Rules & Notices

- MSRB Rule G-17
- MSRB Rule G-19
- MSRB Rule G-27
- MSRB Rule G-32
- MSRB Rule G-36
- MSRB Notice 2008-47
- MSRB Notice 2009-22
- SEA Rule 15c2-12

With respect to initial offerings, the rule prohibits a municipal securities dealer from acting as a participating underwriter of an offering unless, among other things, the underwriter has reviewed an official statement that the issuer has deemed final as of its date. The participating underwriter also must have reasonably determined that the issuer, or an “obligated person,” has entered into a written agreement (the continuing disclosure agreement) to provide certain disclosure to each of the four nationally recognized municipal securities information repositories (NRMSIRs), as well as the appropriate state information depository (SID), if any. This required disclosure includes certain financial information and “notices of certain enumerated material events.”

The requirement to ensure that such an agreement has been reached is critical because of the importance of these notices and of the required financial information to the municipal securities market. The rule enumerates the following material events:

- Principal and interest payment delinquencies;
- Non-payment related defaults;
- Unscheduled draws on debt service reserves reflecting financial difficulties;
- Unscheduled draws on credit enhancements reflecting financial difficulties;
- Substitution of credit or liquidity providers or their failure to perform;
- Adverse tax opinions or events affecting the tax-exempt status of the security;
- Modifications to rights of security holders;
- Bond calls;
- Defeasances;
- Release, substitution or sale of property securing repayment of the securities; and
- Rating changes.

With respect to the secondary market, Rule 15c2-12(c) prohibits any municipal securities dealer from recommending the purchase or sale of a municipal security unless it has procedures in place that provide reasonable assurance that it will receive prompt notice of any material event notice.

### Changes to EMMA

On December 5, 2008, the U.S. Securities and Exchange Commission (SEC) approved amendments to Rule 15c2-12<sup>1</sup> and certain MSRB rules relating to EMMA, the MSRB’s electronic repository of municipal market information. EMMA already provides municipal securities dealers and other market participants with access to official statements filed with the MSRB, as well as advance refunding documents, 529 college savings plan offering documents and real-time and historic trade data for municipal bonds. Beginning July 1, 2009, EMMA will also include continuing disclosures submitted by municipal bond issuers, and will become the sole entity designated by the SEC as a NRMSIR.<sup>2</sup>

These changes may require municipal securities underwriters and dealers to modify current policies and procedures related to compliance with Rule 15c2-12, as well as certain MSRB rules. For example, underwriters will have to reasonably determine that required disclosure is made to the MSRB rather than to the current NRMSIRs as of July 1, 2009.<sup>3</sup> Firms also should review their policies and procedures to make certain they reflect the requirement that material event notices and notices of failure to provide required financial disclosure will be available through EMMA.

The amendments also will affect the small issuer exemption in Rule 15c2-12(d)(2), which may in turn require municipal securities underwriters and dealers to amend their existing policies and procedures with respect to small offerings. The small issuer exemption currently allows for limited or no financial or operating data disclosures if certain requirements are met (including no more than \$10 million in aggregate amount of outstanding municipal securities). For offerings made on or after July 1, 2009, issuers who are eligible for and use the small issuer exemption will need to agree, in writing, to file such financial information or operating data at least annually with the MSRB in an electronic format, as prescribed by the MSRB if such information is customarily prepared and is publicly available.

### **Amendments to MSRB Rule G-32 and G-36**

On May 21, 2009, the SEC also approved amendments to MSRB rules that will consolidate and amend current Rule G-36, relating to the delivery of official statements, and Rule G-32, governing disclosures in connection with new issues. As a result, firms will have to modify their policies and procedures relating to the delivery of official statements in connection with primary offerings of municipal securities.<sup>4</sup> The amendments were effective June 1, 2009, and, in addition to implementing some transitional and recordkeeping requirements, accomplish the following:

- Authorize the MSRB to launch EMMA as its primary municipal market disclosure service;
- Allow the MSRB to implement an “access equals delivery” standard for dissemination of official statements;
- Consolidate the new issue disclosure requirements of MSRB Rule G-32 and the official statement filing requirements of Rule G-36 into new Rule G-32 on disclosures in connection with primary offerings, which requires underwriters to file official statements with the MSRB electronically via EMMA;
- Implement new filing and/or notification requirements when an issue of municipal securities is exempt from Rule 15c2-12; and
- Replace Forms G-36(OS) and G-36(ARD) with new Form G-32.

Firms underwriting or selling primary offerings of municipal securities should familiarize themselves with these rule amendments and review and modify their existing policies and procedures concerning the delivery of official statements accordingly. For additional information, please refer to MSRB Notice 2009-22 ([www.msrb.org/msrb1/whatsnew/2009-22.asp](http://www.msrb.org/msrb1/whatsnew/2009-22.asp)).

### Disclosure, Suitability and Supervision

FINRA urges municipal securities dealers—including those whose business activities are limited to the secondary market—to reassess the adequacy of their current policies and procedures for complying with their obligations under MSRB rules generally, giving particular attention to those relating to:

- the disclosure of material information;
- the suitability of recommendations to customers; and
- the supervision of the firm’s municipal securities activities.

MSRB Rule G-17 provides that, in the conduct of its municipal securities activities, each dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice. The MSRB has interpreted Rule G-17 to require a dealer, in connection with any transaction in municipal securities, to disclose to its customer, at or prior to the sale, all material facts about the transaction known by the dealer, as well as material facts about the security that are reasonably accessible to the market.

In addition, MSRB Rule G-19 requires a dealer that recommends a municipal security to have reasonable grounds for believing that the recommendation is suitable, based upon information available from the issuer of the security, or otherwise, and the facts disclosed by or otherwise known about the customer.<sup>5</sup>

If a firm discovers through its Rule 15c2-12 procedures or otherwise that an issuer has failed to make filings required under its continuing disclosure agreements, the firm must take this information into consideration in meeting its obligations under Rule G-17 and in assessing the suitability of the issuer’s bonds under Rule G-19.

Finally, MSRB G-27 requires firms to supervise their municipal securities business, and to ensure that they have adequate policies and procedures in place for monitoring the effectiveness of their supervisory systems. Specifically, firms must:

- supervise the conduct of the municipal securities activities of the firm and associated persons to ensure compliance with all MSRB rules, the Exchange Act and the rules thereunder;

- have adequate written supervisory procedures; and
- implement supervisory controls to ensure that their supervisory procedures are adequate.

Beginning July 1, 2009, these procedures should include requiring and training associated persons to access all relevant information from EMMA and other established industry sources before selling or recommending a municipal security, whether in connection with an initial offering or in the secondary market.

The MSRB has published information and guidance about its rules, as well as changes to EMMA, at [www.msrb.org](http://www.msrb.org). The EMMA Web site may be accessed at [www.emma.msrb.org](http://www.emma.msrb.org).

## Endnotes

- 1 See MSRB Notice 2008-47 ([www.msrb.org/MSRB1/whatsnew/2008-47.asp](http://www.msrb.org/MSRB1/whatsnew/2008-47.asp)).
- 2 The amendments also eliminate the requirement that underwriters ensure that the continuing disclosure agreement obligates issuers to file with applicable SIDs; however, issuers may still be required to do so under state law.
- 3 For disclosure prior to July 1, 2009, underwriters would need to look to the NRMSIRs that were then operating rather than EMMA, unless the issuer voluntarily files pre-July 1, 2009, disclosures with EMMA.
- 4 See Exchange Act Release No. 59966 (May 21, 2009).
- 5 Like NASD Rule 2310, MSRB Rule G-19's suitability obligation requires both a "reasonable basis" determination that the recommended security is suitable for at least some investors, and a "customer-specific" analysis that the security is suitable for the specific customer to whom the recommendation is made. To meet the customer-specific prong of the suitability obligation, a dealer must make reasonable efforts to obtain information concerning the customer's financial status, tax status and investment objectives, as well as any other information reasonable and necessary in making the recommendation. See MSRB Reminder of Customer Protection Obligations in Connection With Sales of Municipal Securities (May 30, 2007); and MSRB Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans (August 7, 2006).