On February 7, 2012, the Commission instituted proceedings to determine whether to disapprove the proposed rule changes, as modified by Amendments No. 1.[11] On February 16, 2012, the Exchanges each filed Partial Amendment No. 2 to their proposals, which the Commission published for comment in the **Federal Register** on March 1, 2012 (''Notice of Partial Amendment No. 2'').[12] In response to the Order Instituting Proceedings and the Notice of Partial Amendment No. 2, the Commission received four additional comment letters on the proposals.[13] On March 20, 2012, the Exchanges submitted a consolidated rebuttal letter in response to the Order Instituting Proceedings.[14] Additionally, on April 10, 2012, the Exchanges submitted a consolidated response to the comments concerning Partial Amendments No. 2.[15]

Section 19(b)(2) of the Act[16] provides that, after initiating disapproval proceedings, the Commission shall issue an order approving or disapproving the proposed rule changes not later than 180 days after the date of publication of notice of their filing. The Commission may extend the period for issuing an order approving or disapproving the proposed rule changes, however, by up to 60 days if the Commission determines that a longer period is appropriate and publishes the reasons for such determination. In this case, the proposed rule changes were published for notice and comment in the **Federal Register** on November 9, 2011; May 7, 2012, is 180 days from that date, and July 6, 2012, is 240 days from that date.

The Commission finds it appropriate to designate a longer period within which to issue an order approving or disapproving the proposed rule changes so that it has sufficient time to consider the Program and the issues that commenters have raised concerning the Program. Specifically, as the Commission noted in the Order Instituting Proceedings, the Program raises several notable issues, including whether the Program is consistent with the Sub-Penny Rule and with the Quote Rule. The Commission's resolution of these issues could have an impact on overall market structure. As a result, the Commission continues to consider whether the proposed rule changes are consistent with these particular Regulation NMS Rules and with the Act.

Accordingly, the Commission, pursuant to Section 19(b)(2) of the Act,[17] designates July 6, 2012, as the date by which the Commission shall either approve or disapprove the proposed rule changes (File Nos. SR–NYSE–2011–55 and SR–NYSEAmex–2011–84).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[18]

Kevin M. O'Neill,

Deputy Secretary.

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data stream; and (4) to limit the Retail Liquidity Program to securities that trade at prices equal to or greater than $1 per share.

[11] *See* Securities Exchange Act Release No. 66346, 77 FR 7628 (February 13, 2012) (''Order Instituting Proceedings'').

[12] *See* Securities Exchange Act Release No. 66464 (February 24, 2012), 77 FR 12629.

[13] *See* Letters to the Commission from Leonard Amoruso, General Counsel, Knight Capital, Inc., dated March 7, 2012 (''Knight Letter II''); Kurt Schact, CFA, Managing Director, Rhodri Preece, CFA, Director, Capital Markets Policy, and James Allen, CFA, Head, Capital Markets Policy, CFA Institute, dated March 21, 2012 (''CFA Letter II''); Ann Vlcek, Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated March 23, 2012 (''SIFMA Letter II''); and Jim Toes, President and CEO, and Jennifer Green Setzenfand, Chairman, Security Traders Association, dated April 26, 2012.

[14] *See* Letter to the Commission from Janet McGinnis, Senior Vice President, Legal & Corporate Secretary, Legal & Government Affairs, NYSE Euronext, dated March 20, 2012 (''Exchanges' Response Letter II'').

[15] *See* Letter to the Commission from Janet McGinnis, Senior Vice President, Legal & Corporate Secretary, Legal & Government Affairs, NYSE Euronext, dated April 10, 2012 (''Exchanges' Response Letter III'').

[16] 15 U.S.C. 78s(b)(2).

[17] 15 U.S.C. 78s(b)(2).

[18] 17 CFR 200.30–3(a)(57).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–66927; File No. SR–MSRB–2011–09]

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Approving Proposed Rule Change, as Modified by Amendment No. 2, Consisting of Interpretive Notice Concerning the Application of MSRB Rule G–17 to Underwriters of Municipal Securities

May 4, 2012.

I. Introduction

On August 22, 2011, the Municipal Securities Rulemaking Board (''MSRB'' or ''Board'') filed with the Securities and Exchange Commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'' or ''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change consisting of an interpretive notice concerning the application of MSRB Rule G–17 (Conduct of Municipal Securities and Municipal Advisory Activities) to underwriters of municipal securities (''Interpretive Notice''). The proposed rule change was published for comment in the **Federal Register** on September 9, 2011.[3] The Commission received five comment letters on the proposed rule change.[4] On October 11, 2011, the MSRB extended the time period for Commission action to December 7, 2011. On November 3, 2011, the MSRB filed Amendment No. 1 to the proposed rule change. On November 10, 2011, the MSRB withdrew Amendment No. 1, responded to comments,[5] and filed Amendment No. 2 to the proposed rule change. The proposed rule change, as modified by Amendment No. 2, was published for comment in the **Federal Register** on November 21, 2011.[6] The Commission received eight comment letters on the proposed rule change, as modified by Amendment No. 2, and a second response from the MSRB.[7] On December 6, 2011, the MSRB extended the time period for Commission action to

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 65263 (September 6, 2011), 76 FR 55989 (''Original Notice of Filing'').

[4] *See* letters from Joy A. Howard, Principal, WM Financial Strategies, dated September 30, 2011 (''WM Letter I''); Mike Nicholas, Chief Executive Officer, Bond Dealers of America, dated September 30, 2010 (''BDA Letter I''); Colette J. Irwin-Knott, CIPFA, President, National Association of Independent Public Finance Advisors, dated September 30, 2011 (''NAIPFA Letter I''); Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated September 30, 2011 (''SIFMA Letter I''); and Susan Gaffney, Director, Federal Liaison Center, Government Finance Officers Association, dated October 3, 2011 (''GFOA Letter I'').

[5] *See* letter from Margaret C. Henry, General Counsel, Market Regulation, MSRB, dated November 10, 2011 (''Response Letter I'').

[6] *See* Securities Exchange Act Release No. 65749 (November 15, 2011), 76 FR 72013 (''Amended Notice of Filing'').

[7] *See* letters from Colette J. Irwin-Knott, CIPFA, President, National Association of Independent Public Finance Advisors, dated November 30, 2011 (''NAIPFA Letter II''); E. John White, Chief Executive Officer, Public Financial Management, Inc., dated November 30, 2011 (''PFM Letter I''); Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated November 30, 2011 (''SIFMA Letter II''); Joy A. Howard, Principal, WM Financial Strategies, dated November 30, 2011 (''WM Letter II''); Michael Nicholas, CEO, Bond Dealers of America, dated December 1, 2011 (''BDA Letter II''); Susan Gaffney, Director, Federal Liaison Center, Government Finance Officers Association, dated December 1, 2011 (''GFOA Letter II''); Robert Doty, AGFS, dated December 1, 2011 (''AGFS Letter''); and Peter C. Orr, CFA, President, Intuitive Analytics LLC, dated December 7, 2011 (''IA Letter''). *See* letter from Margaret C. Henry, General Counsel, Market Regulation, MSRB, dated December 7, 2011 (''Response Letter II'').

December 8, 2011. On December 8, 2011, the Commission instituted proceedings under Section 19(b)(2)(B) of the Act to determine whether to approve or disapprove the proposed rule change.[8] The Commission received five comment letters and two additional responses from the MSRB.[9] On March 5, 2012, the MSRB extended the time period for Commission action to May 4, 2012. This order approves the proposed rule change, as modified by Amendment No. 2.

II. Description of the Proposal

The MSRB proposes to adopt an interpretive notice with respect to MSRB Rule G–17, which states that ''[i]n the conduct of its municipal securities or municipal advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.''

The Interpretive Notice would apply to dealers acting as underwriters and their duty to municipal entity[10] issuers of municipal securities in negotiated underwritings (except where the Interpretive Notice indicates that it also applies to competitive underwritings), but would not apply to selling group members or when a dealer is serving as an advisor to a municipal entity. The Interpretive Notice would include the following sections: (1) Basic Fair Dealing Principle; (2) Role of the Underwriter/Conflicts of Interest; (3) Representations to Issuers; (4) Required Disclosures to Issuers; (5) Underwriter Duties in Connection with Issuer Disclosure Documents; (6) Underwriter Compensation and New Issue Pricing; (7) Conflicts of Interest; (8) Retail Order Periods; and (9) Dealer Payments to Issuer Personnel.

A. Basic Fair Dealing Principle

The Interpretive Notice would interpret Rule G–17's duty to deal fairly with all persons as providing that an underwriter must not misrepresent or omit the facts, risks, potential benefits, or other material information about municipal securities activities undertaken with a municipal entity issuer. The Interpretive Notice would also state that MSRB Rule G–17 establishes a general duty of a dealer to deal fairly with all persons (including, but not limited to, issuers of municipal securities), even in the absence of fraud.

B. Role of the Underwriter/Conflicts of Interest

The Interpretive Notice would state that MSRB Rule G–17's duty to deal fairly with all persons requires the underwriter to make certain disclosures to the issuer of municipal securities to clarify the underwriter's role in an issuance of municipal securities and the actual or potential material conflicts of interest with respect to such issuance, as described below.

1. Disclosures Concerning the Underwriter's Role

An underwriter must disclose the following information to an issuer: (A) MSRB Rule G–17 requires an underwriter to deal fairly at all times with both municipal issuers and investors; (B) the underwriter's primary role is to purchase securities with a view to distribution in an arm's-length commercial transaction with the issuer and it has financial and other interests that differ from those of the issuer; (C) unlike a municipal advisor, the underwriter does not have a fiduciary duty to the issuer under the federal securities laws and is not required by federal law to act in the best interest of the issuer without regard to the underwriter's own financial or other interests; (D) the underwriter has a duty to purchase securities from the issuer at a fair and reasonable price, but must balance that duty with its duty to sell municipal securities to investors at prices that are fair and reasonable; and (E) the underwriter will review the official statement for the issuer's securities in accordance with, and as part of, its responsibilities to investors under the federal securities laws, as applied to the facts and circumstances of the transaction. Moreover, the Interpretive Notice would state that the underwriter must not recommend that the issuer not retain a municipal advisor.

2. Disclosure Concerning the Underwriter's Compensation

An underwriter must disclose to an issuer whether its underwriting compensation will be contingent on the closing of a transaction. The underwriter must also disclose that compensation that is contingent on the closing of a transaction or the size of a transaction presents a conflict of interest, because it may cause the underwriter to recommend a transaction that is unnecessary or to recommend that the size of the transaction be larger than is necessary.

3. Other Conflicts Disclosures

An underwriter must disclose other potential or actual material conflicts of interest, including, but not limited to, the following: (A) Any payments described below in Section II (G)(1) ''Conflicts of Interest—Payments to or from Third Parties''; (B) any arrangements described below in Section II (G)(2) ''Conflicts of Interest—Profit-Sharing with Investors''; (C) the credit default swap disclosures described below in Section II (G)(3) ''Conflicts of Interest—Credit Default Swaps''; and (D) any incentives for the underwriter to recommend a complex municipal securities financing and other associated conflicts of interest described below in Section II (D) ''Required Disclosures to Issuers.''

Disclosures concerning the role of the underwriter and the underwriter's compensation could be made by a syndicate manager on behalf of other syndicate members. Other conflicts disclosures must be made by the particular underwriters subject to such conflicts.

4. Timing and Manner of Disclosures

All of the foregoing disclosures must be made in writing to an official of the issuer that the underwriter reasonably believes has the authority to bind the issuer by contract with the underwriter and that, to the knowledge of the underwriter, is not a party to a disclosed conflict. The Interpretive Notice would specify that the disclosures must be made in a manner designed to make clear to such official the subject matter of the disclosures and their implications for the issuer.

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[8] *See* Securities Exchange Act Release No. 65918 (December 8, 2011), 76 FR 77865 (December 14, 2011).

[9] *See* letters from Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated January 27, 2012 (''SIFMA Letter III''); Michael Nicholas, Chief Executive Officer, Bond Dealers of America, dated January 30, 2012 (''BDA Letter III''); Colette J. Irwin-Knott, CIPFA, President, National Association of Independent Public Finance Advisors, dated January 30, 2012 (''NAIPFA Letter III''); Susan Gaffney, Director, Federal Liaison Center, Government Finance Officers Association, dated January 30, 2012 (''GFOA Letter III''); and John H. Bonow, Chief Executive Officer, Public Financial Management, Inc., dated February 13, 2012 (''PFM Letter II''). *See* letters from Margaret C. Henry, General Counsel, Market Regulation, MSRB, dated January 30, 2012 (''Response Letter III'') and Margaret C. Henry, General Counsel, Market Regulation, MSRB, dated February 13, 2012 (''Response Letter IV'').

[10] The Interpretive Notice would define the term ''municipal entity'' as that term is defined by Section 15B(e)(8) of the Exchange Act: ''Any State, political subdivision of a State, or municipal corporate instrumentality of a State, including—(A) any agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality; (B) any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and (C) any other issuer of municipal securities.'' *See* Interpretive Notice at endnote 1.

Disclosure concerning the arm's-length nature of the underwriter-issuer relationship must be made in the earliest stages of the underwriter's relationship with the issuer, for example, in a response to a request for proposals or in promotional materials provided to an issuer. Other disclosures concerning the role of the underwriter and the underwriter's compensation generally must be made when the underwriter is engaged to perform underwriting services, for example, in an engagement letter, not solely in a bond purchase agreement. Other conflicts disclosures must be made at the same time, except with regard to conflicts discovered or arising after the underwriter has been engaged. For example, a conflict may not be present until an underwriter has recommended a particular financing. In that case, the disclosure must be provided in sufficient time before the execution of a contract with the underwriter to allow the official to evaluate the recommendation, as described below in Section II (D) ''Required Disclosures to Issuers.''

5. Acknowledgement of Disclosures

An underwriter must attempt to receive written acknowledgement (other than by automatic email receipt) by the official of the issuer of receipt of the foregoing disclosures. If the official of the issuer agrees to proceed with the underwriting engagement after receipt of the disclosures but will not provide written acknowledgement of receipt, the underwriter may proceed with the engagement after documenting with specificity why it was unable to obtain such written acknowledgement.

C. Representations to Issuers

All representations made by underwriters to issuers of municipal securities in connection with municipal securities underwritings, whether written or oral, must be truthful and accurate and not misrepresent or omit material facts. Underwriters must have a reasonable basis for the representations and other material information contained in the documents they prepare and must refrain from including representations or other information they know or should know is inaccurate or misleading. For example, in connection with a certificate signed by the underwriter that will be relied upon by the issuer or other relevant parties to an underwriting (*e.g.,* an issue price certificate), the dealer must have a reasonable basis for the representations and other material information contained therein.

In addition, an underwriter's response to an issuer's request for proposals or qualifications must fairly and accurately describe the underwriter's capacity, resources, and knowledge to perform the proposed underwriting as of the time the proposal is submitted and must not contain any representations or other material information about such capacity, resources, or knowledge that the underwriter knows or should know to be inaccurate or misleading. Matters not within the personal knowledge of those preparing the response, for example, pending litigation, must be confirmed by those with knowledge of the subject matter. An underwriter must not represent that it has the requisite knowledge or expertise with respect to a particular financing if the personnel that it intends to work on the financing do not have the requisite knowledge or expertise.

D. Required Disclosures to Issuers

The Interpretive Notice would provide that while many municipal securities are issued using financing structures that are routine and well understood by the typical municipal market professional, including most issuer personnel that have the lead responsibilities in connection with the issuance of municipal securities, the underwriter must provide disclosures on the material aspects of structures that it recommends when the underwriter reasonably believes issuer personnel lacks knowledge or experience with such structures.

In cases where the issuer personnel responsible for the issuance of municipal securities would not be well positioned to fully understand or assess the implications of a financing in its totality, because the financing is structured in a unique, atypical, or otherwise complex manner, the underwriter in a negotiated offering that recommends such complex financing has an obligation to make more particularized disclosures than otherwise required in a routine financing.[11] Examples of complex financings include variable rate demand obligations and financings involving derivatives such as swaps. The underwriter must disclose the material financial characteristics of the complex financing, as well as the material financial risks of the financing that are known to the underwriter and reasonably foreseeable at the time of the disclosure.[12] The underwriter must also disclose any incentives to recommend the financing and other associated conflicts of interest.[13] These disclosures must be made in a fair and balanced manner based on principles of fair dealing and good faith.

The Interpretive Notice would provide that the level of required disclosure may vary according to the issuer's knowledge or experience with the proposed financing structure or similar structures, capability of evaluating the risks of the recommended financing, and financial ability to bear the risks of the recommended financing, in each case based on the reasonable

[11] The Interpretive Notice would state that if a complex municipal securities financing consists of an otherwise routine financing structure that incorporates a unique, atypical or complex element and the issuer personnel have knowledge or experience with respect to the routine elements of the financing, the disclosure of material risks and characteristics may be limited to those relating to such unique, atypical or complex element and any material impact such element may have on other features that would normally be viewed as routine. *See* Interpretive Notice at endnote 6.

[12] The Interpretive Notice would provide, as an example, that an underwriter that recommends variable rate demand obligations should inform the issuer of the risk of interest rate fluctuations and material risks of any associated credit or liquidity facilities (for example, the risk that the issuer might not be able to replace the facility upon its expiration and might be required to repay the facility provider over a short period of time). As an additional example, if the underwriter recommends that the issuer swap the floating rate interest payments on the variable rate demand obligations to fixed rate payments, the underwriter must disclose the material financial risks (including market, credit, operational, and liquidity risks) and material financial characteristics of the recommended swap (for example, the material economic terms of the swap, the material terms relating to the operation of the swap, and the material rights and obligations of the parties during the term of the swap), as well as the material financial risks associated with the variable rate demand obligations. Such disclosure should be sufficient to allow the issuer to assess the magnitude of its potential exposure as a result of the complex municipal securities financing. The underwriter must also inform the issuer that there may be accounting, legal, and other risks associated with the swap and that the issuer should consult with other professionals concerning such risks. If the underwriter's affiliated swap dealer is proposed to be the executing swap dealer, the underwriter may satisfy its disclosure obligation with respect to the swap if such disclosure has been provided to the issuer by the affiliated swap dealer or the issuer's swap or other financial advisor that is independent of the underwriter and the swap dealer, as long as the underwriter has a reasonable basis for belief in the truthfulness and completeness of such disclosure. If the issuer decides to enter into a swap with another dealer, the underwriter is not required to make disclosures with regard to that swap. Dealers that recommend swaps or security-based swaps to municipal entities may also be subject to rules of the Commodity Futures Trading Commission (''CFTC'') or those of the Commission. See Interpretive Notice at endnote 7.

[13] The Interpretive Notice would provide that, as an example, a conflict of interest may exist when the underwriter is also the provider of a swap used by an issuer to hedge a municipal securities offering or when the underwriter receives compensation from a swap provider for recommending the swap provider to the issuer. *See* Interpretive Notice at endnote 8.

belief of the underwriter.[14] In all events, the underwriter must disclose any incentives for the underwriter to recommend the complex municipal securities financing and other associated conflicts of interest.

The Interpretive Notice would provide that this disclosure must be made in writing to an official of the issuer whom the underwriter reasonably believes has the authority to bind the issuer by contract with the underwriter in (A) sufficient time before the execution of a contract with the underwriter to allow the official to evaluate the recommendation and (B) a manner designed to make clear to such official the subject matter of such disclosures and their implications for the issuer. The complex financing disclosures must address the specific elements of the financing and cannot be general in nature. Finally, the Interpretive Notice would provide that the underwriter must make additional efforts reasonably designed to inform the official of the issuer if the underwriter does not reasonably believe that the official is capable of independently evaluating the disclosures.

E. Underwriter Duties in Connection With Issuer Disclosure Documents

The Interpretive Notice would note that underwriters often play an important role in assisting issuers in the preparation of disclosure documents, such as preliminary official statements and official statements.[15] These documents are critical to the municipal securities transaction, in that investors rely on the representations contained in the documents in making their investment decisions. Investment professionals, such as municipal securities analysts and ratings services, rely on the representations in forming an opinion regarding the credit.

The Interpretive Notice would provide that a dealer's duty to have a reasonable basis for the representations it makes, and other material information it provides, to an issuer and to ensure that such representations and information are accurate and not misleading extends to representations and information provided by the underwriter in connection with the preparation by the issuer of its disclosure documents, for example, cash flows.

F. Underwriter Compensation and New Issue Pricing

1. Excessive Compensation

The Interpretive Notice would state that an underwriter's compensation for a new issue (including both direct compensation paid by the issuer and other separate payments, values, or credits received by the underwriter from the issuer or any other party in connection with the underwriting), in certain cases and depending upon the specific facts and circumstances of the offering, may be so disproportionate to the nature of the underwriting and related services performed as to constitute an unfair practice with regard to the issuer that it is a violation of MSRB Rule G–17. The Interpretive Notice would state that, among the factors relevant to whether an underwriter's compensation is disproportionate to the nature of the underwriting and related services performed, are the credit quality of the issue, the size of the issue, market conditions, the length of time spent structuring the issue, and whether the underwriter is paying the fee of the underwriter's counsel, or any other relevant costs related to the financing.

2. Fair Pricing

The Interpretive Notice would state that the duty of fair dealing under MSRB Rule G–17 includes an implied representation that the price an underwriter pays to an issuer is fair and reasonable, taking into consideration all relevant factors, including the best judgment of the underwriter as to the fair market value of the issue at the time it is priced.[16] In general, a dealer purchasing bonds in a competitive underwriting for which the issuer may reject any and all bids will be deemed to have satisfied its duty of fairness to the issuer with respect to the purchase price of the issue, as long as the dealer's bid is a bona fide bid as defined in MSRB Rule G–13 [17] that is based on the dealer's best judgment of the fair market value of the securities that are the subject of the bid.

In a negotiated underwriting, the underwriter has a duty under MSRB Rule G–17 to negotiate in good faith with the issuer. This duty would include the obligation of the dealer to ensure the accuracy of representations made during the course of such negotiations, including representations regarding the price negotiated and the nature of investor demand for the securities, for example, the status of the order period and the order book. If, for example, the dealer represents to the issuer that it is providing the ''best'' market price available on the new issue, or that it will exert its best efforts to obtain the ''most favorable'' pricing, the dealer may violate MSRB Rule G–17 if its actions are inconsistent with such representations.[18]

G. Conflicts of Interest

1. Payments to or From Third Parties

The Interpretive Notice would state that in certain cases, compensation received by the underwriter from third parties, such as the providers of derivatives and investments (including affiliates of the underwriters), may color the underwriter's judgment and cause it

[14] The Interpretive Notice would state that even a financing in which the interest rate is benchmarked to an index that is commonly used in the municipal marketplace, such as LIBOR or SIFMA, may be complex to an issuer that does not understand the components of that index or its possible interaction with other indexes. *See* Interpretive Notice at endnote 9.

[15] The Interpretive Notice would state that underwriters that assist issuers in preparing official statements must remain cognizant of the underwriters' duties under federal securities laws. The Interpretive Notice would state that, with respect to primary offerings of municipal securities, the Commission has noted that ''[b]y participating in an offering, an underwriter makes an implied recommendation about the securities'' and ''this recommendation itself implies that the underwriter has a reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offerings.'' *See* Interpretive Notice at endnote 10 and Securities Exchange Act Release No. 26100 (September 22, 1988), 53 FR 37778, 37787 (September 28, 1988) (proposing Exchange Act Rule 15c2–12). Further, the Interpretive Notice would state that, pursuant to Exchange Act Rule 15c2–12(b)(5), an underwriter may not purchase or sell municipal securities in most primary offerings unless the underwriter has reasonably determined that the issuer or an obligated person has entered into a written undertaking to provide certain types of secondary market disclosure and has a reasonable basis for relying on the accuracy of the issuer's ongoing disclosure representations. *See* Interpretive Notice at endnote 10 and Securities Exchange Act Release No. 34961 (November 10, 1994), 59 FR 59590 (November 17, 1994) (adopting continuing disclosure provisions of Exchange Act Rule 15c2–12).

[16] The Interpretive Notice would state that the MSRB has previously observed that whether an underwriter has dealt fairly with an issuer for purposes of MSRB Rule G–17 is dependent upon all of the facts and circumstances of an underwriting and is not dependent solely on the price of the issue. The Notice would refer to MSRB Notice 2009–54 and MSRB Rule G–17 Interpretive Letter—Purchase of New Issue From Issuer, MSRB interpretation of December 1, 1997. *See* Interpretive Notice at endnote 11.

[17] The Interpretive Notice would refer to MSRB Rule G–13(b)(iii), which provides: ''For purposes of subparagraph (i), a quotation shall be deemed to represent a 'bona fide bid for, or offer of, municipal securities' if the broker, dealer or municipal securities dealer making the quotation is prepared to purchase or sell the security which is the subject of the quotation at the price stated in the quotation and under such conditions, if any, as are specified at the time the quotation is made.'' *See* Interpretive Notice at endnote 12.

[18] The Interpretive Notice would refer to MSRB Rule G–17 Interpretive Letter—Purchase of New Issue From Issuer, MSRB interpretation of December 1, 1997. *See* Interpretive Notice at endnote 13.

to recommend products, structures, and pricing levels to an issuer when it would not have done so absent such payments. The MSRB would view the failure of an underwriter to disclose to the issuer the existence of payments, values, or credits received by the underwriter in connection with its underwriting of the new issue from parties other than the issuer, and payments made by the underwriter in connection with such new issue to parties other than the issuer (in either case including payments, values, or credits that relate directly or indirectly to collateral transactions integrally related to the issue being underwritten), to be a violation of the underwriter's obligation to the issuer under MSRB Rule G–17.

For example, the MSRB would consider it to be a violation of MSRB Rule G–17 for an underwriter to compensate an undisclosed third party in order to secure municipal securities business. Similarly, the MSRB would consider it to be a violation of MSRB Rule G–17 for an underwriter to receive undisclosed compensation from a third party in exchange for recommending that third party's services or products to an issuer, including business related to municipal securities derivative transactions. The amount of such third party payments need not be disclosed.

In addition, the underwriter must disclose to the issuer whether the underwriter has entered into any third-party arrangements for the marketing of the issuer's securities.

2. Profit-Sharing With Investors

The Interpretive Notice would state that arrangements between the underwriter and an investor purchasing newly issued securities from the underwriter (including purchases that are contingent upon the delivery by the issuer to the underwriter of the securities) according to which profits realized from the resale by such investor of the securities are directly or indirectly split or otherwise shared with the underwriter would, depending on the facts and circumstances (including, in particular, if such resale occurs reasonably close in time to the original sale by the underwriter to the investor), constitute a violation of the underwriter's fair dealing obligation under MSRB Rule G–17. Such arrangements could also constitute a violation of MSRB Rule G–25(c), which precludes a dealer from sharing, directly or indirectly, in the profits or losses of a transaction in municipal securities with or for a customer.[19]

3. Credit Default Swaps

The Interpretive Notice would state that the issuance or purchase by a dealer of credit default swaps for which the reference is the issuer for which the dealer is serving as underwriter, or an obligation of that issuer, may pose a conflict of interest, because trading in such municipal credit default swaps has the potential to affect the pricing of the underlying reference obligations, as well as the pricing of other obligations brought to market by that issuer. As such, a dealer must disclose the fact that it engages in such activities to the issuers for which the dealer serves as underwriter.

The Interpretive Notice would provide that activities with regard to credit default swaps based on baskets or indexes of municipal issuers that include the issuer or its obligations need not be disclosed, unless the issuer or its obligations represents more than 2% of the total notional amount of the credit default swap or the underwriter otherwise caused the issuer or its obligations to be included in the basket or index.

H. Retail Order Periods

The Interpretive Notice would provide that an underwriter that has agreed to underwrite a transaction with a retail order period must honor such agreement.[20] The Interpretive Notice would provide that a dealer that wishes to allocate securities in a manner that is inconsistent with an issuer's requirements must obtain the issuer's consent.

The Interpretive Notice would state that an underwriter that has agreed to underwrite a transaction with a retail order period must take reasonable measures to ensure that retail clients are bona fide. An underwriter that knowingly accepts an order that has been framed as a retail order when it is not, for example, a number of small orders placed by an institutional investor that would otherwise not qualify as a retail customer would violate MSRB Rule G–17 if its actions are inconsistent with the issuer's expectations regarding retail orders. Moreover, a dealer that places an order that is framed as a qualifying retail order but in fact represents an order that does not meet the qualification requirements to be treated as a retail order, for example, an order by a retail dealer without ''going away'' orders[21] from retail customers when such orders are not within the issuer's definition of ''retail,'' would violate its MSRB Rule G–17 duty of fair dealing.

The Interpretive Notice would specify that the MSRB will continue to review activities relating to retail order periods to ensure that they are conducted in a fair and orderly manner consistent with the intent of the issuer and the MSRB's investor protection mandate.

I. Dealer Payments to Issuer Personnel

The Interpretive Notice would state that dealers are reminded of the application of MSRB Rule G–20 on gifts, gratuities, and non-cash compensation, and MSRB Rule G–17, in connection with certain payments made to, and expenses reimbursed for, issuer personnel during the municipal bond issuance process.[22] The Interpretive Notice would further state that the rules are designed to avoid conflicts of interest and to promote fair practices in the municipal securities market.

The Interpretive Notice would alert dealers to consider carefully whether payments they make in regard to expenses of issuer personnel in the course of the bond issuance process, including in particular, but not limited to, payments for which dealers seek reimbursement from bond proceeds or issuers, comport with the requirements of MSRB Rule G–20. For example, the Interpretive Notice would provide that a dealer acting as a financial advisor or underwriter may violate MSRB Rule G–20 by paying for excessive or lavish travel, meal, lodging and entertainment expenses in connection with an offering such as may be incurred for rating

[19] According to MSRB Rule D–9: ''Except as otherwise specifically provided by rule of the Board, the term 'Customer' shall mean any person other than a broker, dealer, or municipal securities dealer acting in its capacity as such or an issuer in transactions involving the sale by the issuer of a new issue of its securities.''

[20] The Interpretive Notice would refer to MSRB Interpretation on Priority of Orders for Securities in a Primary Offering under Rule G–17, MSRB interpretation of October 12, 2010, reprinted in the MSRB Rule Book. The Notice would remind underwriters of previous MSRB guidance on the pricing of securities sold to retail investors and refer to Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities, MSRB Notice 2009–42 (July 14, 2009). *See* Interpretive Notice at endnote 15.

[21] The Interpretive Notice would state that a ''going away'' order is an order for newly issued securities for which a customer is already conditionally committed and cite Securities Exchange Act Release No. 62715 (August 13, 2010), 75 FR 51128 (August 18, 2010) (SR–MSRB–2009–17). *See* Interpretive Notice at endnote 16.

[22] The Interpretive Notice would cite to MSRB Rule G–20 Interpretation—Dealer Payments in Connection With the Municipal Securities Issuance Process, MSRB interpretation of January 29, 2007, reprinted in the MSRB Rule Book. *See* Interpretive Notice at endnote 17.

agency trips, bond closing dinners, and other functions, that inure to the personal benefit of issuer personnel and that exceed the limits or otherwise violate the requirements of the rule.[23]

III. Discussion and Commission Findings

The Commission has carefully considered the proposed rule change, as modified by Amendment No. 2, the comment letters received, and the MSRB's responses, and finds that the proposed rule change, as modified by Amendment No. 2, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the MSRB. Specifically, the Commission finds that the proposed rule change is consistent with the provisions of Section 15B(b)(2)(C) of the Act,[24] which requires, among other things, that the rules of the MSRB be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons facilitating transactions in municipal securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest. The sections below include a detailed description of the comments received, the MSRB's responses to the comments, and the Commission's findings.

A. Basic Fair Dealing Principle

Commenters generally supported the principle of fair dealing in MSRB Rule G–17.[25] Some commenters expressed their belief that the principle of fair dealing should not be interpreted to impose a fiduciary duty on underwriters to issuers,[26] while other commenters expressed their belief that underwriters have such a duty if they engage in certain activities.[27] In Response Letter I, the MSRB stated that the Interpretive Notice does not impose a fiduciary duty on underwriters and that the duties imposed by the Interpretive Notice on underwriters are no different in many cases from the duties already imposed on them by MSRB rules with respect to other types of customers (*e.g.,* individual investors). Further, the MSRB stated that an underwriter is not required to act in the best interest of an issuer without regard to the underwriter's own financial and other interests and is not required to consider all reasonably feasible alternatives to the proposed financings. Rather, the MSRB stated that one purpose of the Interpretive Notice is to eliminate issuer confusion about the role of the underwriter.

The Commission finds that the proposed provision regarding the basic fair dealing principle of MSRB Rule G–17 is consistent with the Act because it will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest. For example, the Interpretive Notice specifies that MSRB Rule G–17 establishes a general duty to deal fairly with all persons, even in the absence of fraud. In addition, the Commission believes that the MSRB has adequately responded to the comments by, among other things, clarifying the level of the underwriter's duties toward an issuer.

B. Role of the Underwriter/Conflicts of Interest

1. Disclosures Concerning the Underwriter's Role

Some commenters stated that it is important that issuers understand the different roles that underwriters and financial advisors play in a transaction.[28] Other commenters suggested additional disclosures with respect to the role of underwriters.[29] For example, commenters suggested that the MSRB require an underwriter to state: (1) That the underwriter does not have a fiduciary duty to the issuer and is a counterparty at arm's length; [30] (2) that the issuer may choose to engage a financial advisor to represent its interests; [31] (3) that the underwriter is not acting as an advisor; [32] (4) that the underwriter has conflicts with issuers because the underwriter represents the interests of investors and other parties; [33] (5) that the underwriter seeks to maximize profitability; [34] and (6) that the underwriter has no continuing obligation to the issuer after the transaction.[35]

In Response Letter I, the MSRB noted that the Interpretive Notice, as modified by Amendment No. 2, incorporates many of the recommendations suggested by commenters, such as requiring underwriters to provide issuers with disclosure that underwriters do not have a fiduciary duty to issuers. In addition, the MSRB noted that the Interpretive Notice, as modified by Amendment No. 2, requires disclosure regarding the underwriter's role as compared to that of a municipal advisor, and prohibits an underwriter from recommending that the issuer not retain a municipal advisor.[36] The MSRB also stated that it

[23] The Interpretive Notice would cite to *In the Matter of RBC Capital Markets Corporation,* SEC Rel. No. 34–59439 (February 24, 2009) (settlement in connection with broker-dealer alleged to have violated MSRB Rules G–20 and G–17 for payment of lavish travel and entertainment expenses of city officials and their families associated with rating agency trips, which expenditures were subsequently reimbursed from bond proceeds as costs of issuance); *In the Matter of Merchant Capital, L.L.C.,* SEC Rel. No. 34–60043 (June 4, 2009) (settlement in connection with broker-dealer alleged to have violated MSRB rules for payment of travel and entertainment expenses of family and friends of senior officials of issuer and reimbursement of the expenses from issuers and from proceeds of bond offerings). *See* Interpretive Notice at endnote 18.

[24] 15 U.S.C. 78*o*–4(b)(2)(C).

[25] *See, e.g.,* SIFMA Letter I.

[26] *See* SIFMA Letter I; NAIPFA Letter I; and BDA Letter I. Two commenters noted that the appearance of the imposition of a fiduciary duty would confuse municipal issuers on the role of underwriters. *See* NAIPFA Letter I and BDA Letter I. One commenter opposed the appearance of the imposition of a fiduciary duty and noted that municipal issuers often do not understand the disclosures that they are provided and do not benefit from complex disclosures from firms that are not acting in a fiduciary capacity. *See* WM Letter I (stating its belief that the proposal will not improve transparency in the municipal market).

[27] *See, e.g.,* PFM Letter I. This commenter stated that advice given by brokers in their promotion of themselves to become underwriters makes them municipal advisors.

[28] *See, e.g.,* GFOA Letter I and NAIPFA Letter III (stating that ''[a]doption of the Rule is crucial to the prevention of confusion and harm from occurring to municipal issuers'').

[29] One commenter stated that it supports the proposal but believes that additional changes would be required to protect infrequent and/or small and unsophisticated issuers. *See* NAIPFA Letter I and NAIPFA Letter II.

[30] *See* GFOA Letter I; NAIPFA Letter I; GFOA Letter II; and GFOA Letter III. One commenter stated that a simple disclosure from an underwriter to the issuer that the underwriter is not acting as financial advisor and that the issuer should consult with a financial advisor would be sufficient. *See* WM Letter I. Another commenter stated that the requirement for an underwriter to compare its obligations with others, such as a municipal advisor, should be eliminated. *See* BDA Letter II.

[31] *See* GFOA Letter I; GFOA Letter II; GFOA Letter III; and NAIPFA Letter I (requesting a disclosure that an underwriter is no replacement for a municipal advisor and stating that when an issuer engages a municipal advisor, the underwriter disclosures should not overlap with areas covered by the role of municipal advisor).

[32] *See* NAIPFA Letter I.

[33] *See id.*

[34] *See id.*

[35] *See id.*

[36] In Response Letter IV, the MSRB stated that the proposed provision that an underwriter must not recommend that the issuer not retain a municipal advisor is a stronger protection to issuers than a disclosure that an issuer may choose to engage an advisor because the proposed provision ''affirmatively restrains an underwriter from taking action to discourage the use of an advisor rather than simply informing an issuer of a choice it already has and has no reason to believe it does not have.'' *See also* Response Letter II. One commenter agreed with the MSRB that an underwriter should not recommend that an issuer not retain a municipal advisor. *See* BDA Letter II.

does not believe that it is necessary for underwriters to disclose that they seek to maximize profitability and have no continuing obligation to the issuer after the transaction.

One commenter suggested that the MSRB require underwriters to disclose pending litigation that may affect the underwriter's municipal securities business, departure of experts that the issuer relied upon, and transactional risks, including a comparison of different forms of financings.[37] In Response Letter I, the MSRB disagreed that underwriters should disclose the different types of financings that may be applicable to an issuer's particular situation because that is under the domain of the municipal advisor. The MSRB also noted that pending litigation and expert departures that do not rise to the level of conflicts could be required by an issuer as the issuer deems appropriate.[38]

One commenter suggested that the MSRB develop and promote educational information for issuers and other market participants with respect to underwriting pricings and fees.[39] This commenter also suggested that the MSRB develop educational materials for issuers with respect to the information that underwriters must disclose and the appropriate questions that issuers should ask their underwriters regarding a transaction, as well as with respect to the ''fair and reasonable'' standard for the amount that underwriters pay issuers for bonds.[40] In Response Letter I, the MSRB noted that it is in the process of developing educational materials for issuers with respect to the duties owed them by their underwriters under MSRB rules, as suggested by the commenter.

One commenter stated that underwriters should not be required to provide generalized role and compensation disclosures or written risk disclosures to large and frequent issuers unless requested by such issuers.[41] Another commenter stated that the Commission and the MSRB would create confusion by imposing fiduciary-like duties on underwriters through Rule G–17, and that any disclosure requirements must be narrowly drawn to avoid conceptual and practical inconsistencies that would only confuse the parties as to their roles and responsibilities.[42] In Response Letter II, the MSRB noted its disagreement with the comments and stated that providing more information to issuers about the nature of the duties of the professionals they engage—regardless of the issuer's size, sophistication or frequency of accessing the market—can only serve to empower, rather than confuse, issuers. In Response Letter IV, the MSRB declined to modify the requirements for providing written disclosures to large and frequent issuers. The MSRB stated that such issuers may experience turnover in finance personnel, and that disclosures are required to be made to issuer representatives to inform them in their decision making.

The Commission finds that the proposed disclosures concerning the underwriter's role are consistent with the Act because they will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest. In providing municipal issuers with written information regarding such things as the arm's-length nature of the underwriter-issuer relationship and the role of the underwriter, municipal issuers should be better informed to evaluate, among other things, potential risks in engaging a particular underwriter. The disclosures should also help issuers to better understand the role of the underwriter, as compared to that of a municipal advisor. In addition, the required disclosures should benefit issuers, investors, and the public interest, and provide issuers and their advisors with valuable information with which to evaluate underwriter recommendations. Further, the Commission believes that, by providing that an underwriter must not recommend that the issuer not retain a municipal advisor, the Interpretive Notice will help further protect municipal issuers. The Commission agrees with the MSRB that the proposed provision that an underwriter must not recommend that the issuer not retain a municipal advisor is a stronger protection to issuers than a disclosure that an issuer may choose to engage an advisor.[43]

The Commission also believes that the MSRB has adequately addressed the comments regarding the disclosure requirements. Specifically, the Commission notes that, in response to commenters' requests for additional disclosures, the MSRB modified the Interpretive Notice, as originally proposed, by including specific information that an underwriter must disclose to the issuer. In addition, in response to comments, the MSRB stated that it is in the process of developing certain educational materials for issuers with respect to the duties owed them by their underwriters to help further the aim of the required disclosures.[44]

2. Disclosure Concerning the Underwriter's Compensation

One commenter requested additional conflicts of interest disclosures regarding underwriter compensation, such as the manner of such compensation and any associated conflicts of interest.[45] In Response Letter I, the MSRB stated that the Interpretive Notice, as modified by Amendment No. 2, incorporates many of the commenters' recommendations, such as disclosure regarding the conflicts of interest raised by contingent fee compensation.

Another commenter stated that the underwriter should be required to disclose to an issuer, and obtain its informed consent in writing, that the form of the underwriter's compensation creates a conflict of interest because the compensation is based primarily on the size and type of issuance.[46] This commenter also stated that the amount of compensation should be disclosed.[47] On the other hand, one commenter objected to the characterization of contingent fee arrangements as resulting in a conflict of interest with issuers.[48] The commenter stated that such arrangements do not necessarily result in a conflict, and recommended that the disclosure should state that such compensation ''may'' present a conflict or ''may have the potential'' for a conflict.[49]

In Response Letter II, the MSRB stated that it has accurately characterized contingent compensation arrangements as creating a conflict of interest. The MSRB stated that there may be other factors on which an underwriter and the issuer have a coincidence of interests that may outweigh the conflicting interests resulting from the contingent arrangement, but that does not change the fact that such arrangement itself represents a conflict. Further, the MSRB stated that, given the transaction-based

[37] *See* GFOA Letter I. *See also* GFOA Letter II.

[38] According to the Interpretive Notice, disclosures regarding pending litigation against the underwriter must be confirmed by those persons with knowledge of the subject matter.

[39] *See* GFOA Letter I.

[40] *See id.*

[41] *See* SIFMA Letter II. *See also* SIFMA Letter III.

[42] *See* BDA Letter I. *See also* SIFMA Letter I; NAIPFA Letter I; and NAIPFA Letter II.

[43] *See supra* note 36.

[44] *See* Response Letter I.

[45] *See* GFOA Letter I.

[46] *See* NAIPFA Letter I and NAIPFA Letter III.

[47] *See* NAIPFA Letter II. This commenter also suggested that disclosures regarding non-contingent fees may be necessary.

[48] *See* BDA Letter II.

[49] *See id.*

nature of the typical relationship between underwriters and issuers, the proposal's requirements regarding disclosure of compensation conflicts, together with the other conflicts disclosures included in the proposal, adequately address concerns that may arise in cases where potential conflicts may arise under less typical compensation scenarios.

The Commission finds that the proposed disclosure requirements for underwriter's compensation are consistent with the Act because they will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest. Specifically, written disclosures by underwriters regarding such things as whether the underwriter's compensation is contingent on the closing of the transaction, as well as other potential or actual conflicts of interest, should help ensure that municipal issuers are better informed in evaluating, among other things, potential risks of engaging a particular underwriter. Further, the Commission believes that the required disclosures should benefit issuers, investors, and the public interest, and provide issuers and their advisors with valuable information with which to evaluate underwriter recommendations.

In addition, the Commission believes that the MSRB has adequately addressed the comments regarding the compensation disclosure requirements. Specifically, the Commission notes that, in response to a commenter's request for additional conflicts of interest disclosures regarding underwriter compensation, the MSRB modified the Interpretive Notice, as originally proposed, by providing that the underwriter must disclose whether its compensation is contingent, and that contingent compensation presents a conflict of interest.

3. Other Conflicts Disclosures

One commenter stated that when there is a syndicate of underwriters, an underwriter whose participation level is below 10% should be exempted from the disclosure requirements.[50] Another commenter stated that, with respect to underwriter syndicates, underwriters who do not have a role in the development or implementation of the financing structure or other aspects of the issue should not be subject to the disclosure requirements.[51] In Response Letter II, the MSRB declined to adopt the suggested exemptions and stated that not all conflicts or other concerns that arise in the context of an underwriting are necessarily proportionate to the size of participation of an underwriter.[52] The MSRB noted, however, that with respect to disclosures about the material financial characteristics and risks of an underwriting transaction recommended by underwriters, where such recommendation is made by the syndicate manager on behalf of the underwriting syndicate, the Interpretive Notice does not prohibit syndicate members from delegating to the syndicate manager (through, for example, the agreement among underwriters) the task of delivering such disclosure in a full and timely manner on behalf of the syndicate members, although each syndicate member would remain responsible for providing disclosures with respect to conflicts specific to such member.

As discussed in further detail below in Sections III.D. and III.G., the Commission finds that disclosures concerning other conflicts of interest are consistent with the Act because they will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest. The Commission also believes that it is consistent with the Act to not provide the exemptions from the disclosure requirements suggested by commenters. As the MSRB noted, not all conflicts or other concerns that arise in the context of an underwriting are necessarily proportionate to the size of an underwriter's participation.[53]

4. Timing and Manner of Disclosures

With respect to the disclosure process, one commenter stated that underwriters should be subject to a process similar to the more rigorous process for municipal advisors under the municipal advisor portion of proposed MSRB Rules G–17 and G–36.[54] The commenter stated that providing disclosures is inadequate; rather, underwriters should be required to obtain informed consent from issuers. Moreover, the commenter stated that disclosures should be made to officials of the municipal entity with the power to bind the issuer, such as to the issuer's governing body.[55] Alternatively, the commenter stated that the Interpretive Notice should be amended to prohibit the giving of disclosures based on a reasonable belief standard and instead require underwriters to have actual knowledge of whether an official has the power to bind the issuer by contract.[56] On the other hand, one commenter suggested that disclosures should be made to an official that the underwriter reasonably believes ''has or will have'' the authority to bind the issuer by contract, instead of an official that the underwriter believes ''has'' the requisite authority.[57] The commenter stated that due to the nature of these transactions, at the time of disclosure, there may not be an official with such authority as the authority may not be granted until later.

In Response Letter I, the MSRB stated that it is not necessary for underwriters to obtain consent from the issuer's governing body when the issuer finance officials have been delegated the ability to contract with the underwriter. The MSRB stated that it is not necessary for a contract to have been executed in order for an underwriter to have a reasonable belief that an issuer official has the requisite power to bind the issuer. Further, in Response Letter II, the MSRB noted that an official, such as a finance director, who is expected to receive the delegation of authority from the governing body to bind the issuer, could reasonably be viewed as an acceptable recipient of disclosures provided such expectation remains reasonable.

One commenter stated that the Interpretive Notice should provide that the disclosure regarding the arm's-length nature of the underwriter-issuer relationship must be made in a response to a request for proposals or in promotional materials provided to an issuer, rather than ''at the earliest stages'' of the relationship as proposed, because the proposed standard is vague and ambiguous.[58] This commenter also requested clarification with respect to when ''other conflicts'' disclosures must be made. Another commenter requested

[50] *See* SIFMA Letter II. *See also* SIFMA Letter III.

[51] *See* BDA Letter II.

[52] *See also* Response Letter IV.

[53] *See* Response Letter II.

[54] *See* NAIPFA Letter I. The Commission notes that these proposals were subsequently withdrawn by the MSRB. *See* Securities Exchange Act Release Nos. 65397 (September 26, 2011), 76 FR 60955 (September 30, 2011) (SR–MSRB–2011–14) (withdrawing proposed MSRB Rule G–36 and interpretive guidance concerning MSRB Rule G–36); and 65398 (September 26, 2011), 76 FR 60958 (September 30, 2011) (SR–MSRB–2011–15) (withdrawing proposed interpretive notice concerning MSRB Rule G–17).

[55] *See* NAIPFA Letter I and NAIPFA Letter II. One commenter stated its disagreement with the commenters who would require underwriters to make disclosures to the issuer's governing body. *See* SIFMA Letter III.

[56] *See* NAIPFA Letter I and NAIPFA Letter II. *But see* SIFMA Letter III (stating that underwriters should not be required to have actual knowledge that the official receiving the disclosures has the power to bind the issuer by contract).

[57] *See* BDA Letter II.

[58] *See id.*

clarification regarding the meaning of ''execution of a contract'' with respect to the timing of the risk disclosures.[59] This commenter stated that execution of the bond purchase agreement should be the appropriate measurement. In Response Letter II, the MSRB clarified that, other than the disclosure with respect to the arm's-length nature of the relationship, the remaining disclosures regarding the underwriter's role, compensation and other conflicts of interest all must be provided when the underwriter is engaged to perform underwriting services (such as in an engagement letter), not solely in the bond purchase agreement. The MSRB also clarified that the ''contract'' with respect to the timing of the risk disclosures is the bond purchase agreement.[60]

One commenter suggested that the underwriter make its disclosures to the issuer in plain English to ensure that the issuer understands such disclosures.[61] In Response Letter II, the MSRB stated that it agrees that reasonable efforts must be made to make the disclosures understandable, that disclosures must be made in a fair and balanced manner and, if the underwriter does not reasonably believe that the official to whom the disclosures are addressed is capable of independently evaluating the disclosures, the underwriter must make additional efforts reasonably designed to inform the issuer or its employees or agent.[62]

The Commission finds that the proposed timing and manner of disclosure are consistent with the Act because they will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest. Specifically, the Commission believes that the proposed timing and manner of disclosure will help to ensure that municipal issuers are fully and timely informed of the underwriter's role and any potential or actual conflicts of interest. Further, as noted by the MSRB, such provisions would provide guidance as to conduct required to comply with the fair dealing component of Rule G–17.[63]

In addition, the Commission believes that the MSRB has adequately addressed the comments regarding the timing and manner of disclosure. The Commission notes that, in response to comments, the MSRB modified the Interpretive Notice, as originally proposed, by specifically setting forth near the beginning of the Interpretive Notice the appropriate timing and manner of disclosure. The MSRB also provided clarification with respect to the timing of disclosure and the party to whom the disclosure must be made. In addition, the Commission notes that the MSRB has committed to monitoring matters relating to the timing of disclosure in order to determine whether any further action with respect to timing is merited.[64]

5. Acknowledgement of Disclosures

One commenter stated that the requirement for issuer written acknowledgement of the receipt of disclosures would be helpful.[65] However, in situations where written acknowledgement is not received from the issuer, the commenter urged the MSRB to require underwriters to put forth some level of effort to obtain the written acknowledgement. Another commenter stated that it believes that an underwriter should not be required to document why an official of the issuer does not acknowledge in writing that disclosures were received.[66] Instead, the commenter recommended that the underwriter should only be required to document that disclosures were made and whether acknowledgement was received.

In Response Letter II, the MSRB clarified that if an issuer does not provide the underwriter with written acknowledgement of the receipt of disclosures, the failure to receive such acknowledgement must be documented, as well as what actions were taken to attempt to obtain the acknowledgement, in order for the underwriter to fulfill its obligation under MSRB Rule G–17 to deal fairly with the issuer.

The Commission finds that the proposed provisions concerning the issuer's acknowledgement of the receipt of disclosures are consistent with the Act. The Commission believes that the proposed provisions will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest by helping to ensure that the issuer receives appropriate disclosures from the underwriter. For example, the Commission notes that, in response to comments, the MSRB modified the Interpretive Notice, as originally proposed, by specifically setting forth near the beginning of the Interpretive Notice the provisions with respect to the timing and acknowledgment of receipt of the disclosures, including the obligation to document the failure to receive such acknowledgement. In addition, in Response Letter II, the MSRB provided clarification with respect to the underwriter's obligation to document the failure to receive such acknowledgement.

C. Representations to Issuers

According to the Interpretive Notice, an underwriter must have a reasonable basis for the representations and material information contained in a certificate that will be relied upon by the municipal entity issuer or other relevant parties to an underwriting. One commenter stated that one example of such a certificate used by the MSRB in the Interpretive Notice (*i.e.,* an issue price certificate) is already regulated by tax laws and does not need additional regulation by the MSRB.[67] In Response Letter IV, the MSRB disagreed with the comment that evaluating the reasonableness of an issue price certificate should be left to the tax authorities, and stated that ''the reasonableness of an underwriter's representation in an issue price certificate may have a direct effect on a key representation that an issuer makes to potential investors—that interest on its securities is tax exempt.''

The Commission finds that the proposed provisions with respect to representations to issuers are consistent with the Act. The Commission believes that these provisions will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest by helping to ensure that all representations made by underwriters to issuers in connection with municipal securities underwritings are truthful and accurate. Also, as noted by the MSRB, such provisions would provide guidance as to conduct required to

[59] *See* SIFMA Letter II. This commenter also requested clarification with respect to how underwriters would satisfy the disclosure requirements in situations where the financing terms are determined in a short period of time, such as within a 24-hour window. *See* SIFMA Letter II and SIFMA Letter III. In Response Letter II, the MSRB stated that ''if an underwriter is asking an issuer to bind itself to the terms of a complex financing, it is unreasonable for the underwriter to expect the issuer to do so without having an opportunity to fully understand the nature of its commitment.'' *See also* Response Letter IV.

[60] *See also* Response Letter IV.

[61] *See* GFOA Letter II and GFOA Letter III.

[62] *See also* Response Letter IV.

[63] *See* Amended Notice of Filing, *supra* note 6 at 72015 (stating that ''[t]he sections of the Notice entitled 'Role of the Underwriter/Conflicts of Interest,' 'Required Disclosures to Issuers,' 'Fair Pricing,' and 'Credit Default Swaps' primarily would provide guidance as to conduct required to comply with the fair dealing component of the rule''). *See also* Response Letter III.

[64] *See* Response Letter II.

[65] *See* NAIPFA Letter II.

[66] *See* BDA Letter II.

[67] *See* SIFMA Letter I. *See also* SIFMA Letter III.

comply with the anti-fraud component of Rule G–17.[68] In addition, the Commission believes that the MSRB has adequately addressed the comment with respect to issue price certificates.

D. Required Disclosures to Issuers

One commenter stated that the disclosure requirements, especially for routine transactions, should only be imposed when the underwriter has reason to believe that the issuer does not have the knowledge or experience available to understand the transaction.[69] The commenter also noted that ''issuer personnel responsible for the issuance of municipal securities'' and ''an official of the issuer whom the underwriter reasonably believes has the authority to bind the issuer by contract with the underwriter'' are not the same.[70] Thus, the commenter stated that clarification should be provided that these regulatory requirements are imposed on the underwriter only if the underwriter has reason to believe that issuer personnel do not have the requisite knowledge or experience, regardless of whether the particular official who the underwriter reasonably believes to have the legal authority to contractually bind the issuer can be reasonably thought to have the requisite knowledge and experience. Another commenter stated that the Interpretive Notice should be amended to take into consideration the needs of unsophisticated municipal issuers, and underwriters should be required to assess the knowledge and understanding of municipal issuers on a case-by-case basis.[71] In Response Letter I, the MSRB stated that it does not consider it unduly burdensome to require an underwriter to evaluate the level of knowledge and sophistication of issuer personnel, particularly considering that under the Interpretive Notice, as modified by Amendment No. 2, the underwriter need only have a reasonable basis for its evaluation. In Response Letter IV, the MSRB also noted that in the Interpretive Notice, it provided guidance on the factors that are relevant in coming to the reasonable belief.[72]

One commenter stated that the underwriter should not be required to evaluate issuer personnel when the issuer has retained a municipal advisor.[73] This commenter also stated that the written risk disclosures imposed on underwriters related to the financings do not take into account the role of the issuer's municipal advisor, if any.[74] Other commenters stated that in a negotiated sale, when the issuer of municipal securities engages a registered municipal advisor, disclosures should be reduced or eliminated.[75] In Response Letter I, the MSRB stated that underwriters are in the best position to understand the material financial terms and risks associated with recommended financings, and the burden should not be solely on municipal advisors to ascertain such terms and risks.

One commenter stated that the written risk disclosures imposed on underwriters related to the financings (including complex financings) are too broad and vague.[76] This commenter noted that if written risk disclosures are to be required, then additional guidance and clarity is needed on the following: (1) References to ''atypical or complex'' financings; (2) references to ''all material risks and characteristics of the complex municipal securities financing;'' (3) which issuer personnel must have the requisite level of knowledge and sophistication; (4) if the issuer does not have a financial advisor or internal personnel acting in a similar role, then the issuer's finance staff's knowledge and experience should be assessed by underwriters; and (5) only material risks that are known to the underwriter and reasonably foreseeable at the time of the disclosure should be required.

In Response Letter I, the MSRB stated that it does not consider it appropriate to provide a more precise definition of ''complex municipal securities financing'' since the Interpretive Notice already provides the comparison to a fixed rate financing and examples of financings that are considered to be complex, such as those involving variable rate demand obligations and swaps.[77] In addition, the MSRB stated that if there is any doubt on the part of the underwriter as to whether a financing is complex, it should err on the side of concluding that the financing is complex and provide the requisite disclosures. On the other hand, the MSRB noted that the Interpretive Notice, as modified by Amendment No. 2, would limit disclosures of a complex municipal securities financing recommended by the underwriter to its material financial characteristics, and its material financial risks that are known to the underwriter and reasonably foreseeable at the time of disclosure (rather than all material risks and

[68] *See* Amended Notice of Filing, *supra* note 6 at 72015 (stating that ''[t]he sections of the Notice entitled 'Representations to Issuers,' 'Underwriter Duties in Connection with Issuer Disclosure Documents,' 'Excessive Compensation,' 'Payments to or from Third Parties,' 'Profit-Sharing with Investors,' 'Retail Order Periods,' and 'Dealer Payments to Issuer Personnel' primarily would provide guidance as to conduct required to comply with the anti-fraud component of the rule and, in some cases, conduct that would violate the anti-fraud component of the rule, depending on the facts and circumstances''). *See also* Response Letter III.

[69] *See* BDA Letter I. One commenter suggested factors to determine when disclosures would not be necessary for routine financings. *See* NAIPFA Letter I. In Response Letter I, the MSRB stated that while the factors are helpful, they do not address the particular issuer personnel's experience and knowledge, which are more relevant to the Interpretive Notice. Another commenter stated its belief that ''it can do no harm for the underwriter to provide information about routine financings to the issuer personnel who are charged by the government to execute the financing.'' *See* GFOA Letter II and GFOA Letter III. This commenter further stated that the amount of materials and explanations provided may need to be determined through conversations with the issuer personnel. Further, this commenter stated that it would not be unreasonable for the rule to state that the underwriter may be asked by issuer personnel to make disclosures about routine financings to others on the finance team or the members of a governing board who gave the authorization for the financing. In Response Letter II, the MSRB stated its belief that the provisions relating to risk disclosure are appropriate for the reasons described in Response Letter I and, therefore, no further modification is warranted.

[70] Another commenter noted that the issue of how the underwriter should identify the person to whom it must provide information deserves further discussion. *See* GFOA Letter II and GFOA Letter III. In Response Letter II, the MSRB noted that it would monitor disclosure practices and would engage in a dialogue with industry participants and the Commission to determine whether sufficient improvements have occurred in the flow of disclosures to decision-making personnel of issuers or whether additional steps should be taken.

[71] *See* NAIPFA Letter I and NAIPFA Letter II. The commenter also stated that the proposal requires additional changes in order to protect the infrequent and/or small, unsophisticated issuers of municipal bonds. *See* NAIPFA Letter II. Another commenter stated that there are many unsophisticated issuers who will benefit from the disclosures. *See* AGFS Letter.

[72] According to the Interpretive Notice, the level of disclosure required may vary according to the issuer's knowledge or experience with the proposed financing structure or similar structures, capability of evaluating the risks of the recommended financing, and financial ability to bear the risks of the recommended financing. *See* Interpretive Notice.

[73] *See* SIFMA Letter I and SIFMA Letter II.

[74] *See* SIFMA Letter I. *See also* SIFMA Letter II and SIFMA Letter III.

[75] *See, e.g.,* NAIPFA Letter II; SIFMA Letter II; WM Letter II; and BDA Letter I. One commenter stated that if the issuer has a financial advisor or internal personnel serving the same role, then no underwriter written risk disclosures should be required. *See* SIFMA Letter I. The commenter further recommended that underwriters may satisfy their disclosure requirements by communicating the disclosures to the financial advisor or issuer internal personnel. This commenter stated that the underwriter should be permitted to assume, without further inquiry, that the finance staff will use its expertise to communicate the disclosure in an appropriate manner to other decision makers. *See also* SIFMA Letter II and SIFMA Letter III. In Response Letter IV, the MSRB stated that ''it is essential for issuer representatives to be the recipients of the required disclosures as they are the ones that must decide whether to accept their underwriters' recommendations.''

[76] *See* SIFMA Letter I. *See also* SIFMA Letter III.

[77] *See also* Response Letter IV.

characteristics), and would provide examples of the types of disclosures in the case of swaps.

One commenter stated that if an issuer has no financial advisor or internal financial department, the written disclosure requirements should not be triggered unless the issuer informs the underwriter that it lacks knowledge or experience and specifically requests such written disclosure in writing.[78] In Response Letter I, the MSRB stated that it does not consider it appropriate to require an issuer to inform the underwriter that it lacks knowledge or experience with a financing as a condition of receiving disclosures from the underwriter because this would put the burden on the party least able to understand the transaction and its rights to disclosure.

One commenter stated that it would not be appropriate or practical to impose upon the underwriter the duty to assess the level of sophistication and experience of the issuer official to whom the disclosure is delivered, if the official is reasonably believed to have the authority to bind the issuer.[79] The commenter stated that the underwriter should be permitted to rely on a representation from such official that he or she is sufficiently sophisticated and experienced, and issuers should be responsible for ensuring that they authorize appropriate personnel to contract for them.[80] In Response Letter IV, the MSRB stated its expectation that if it were to provide the clarification that the commenter requested, issuers would be provided with boilerplate language requesting that they waive this disclosure requirement, and many of those that actually read the language ''would be loath to admit that they lacked sophistication or experience.''

One commenter disagreed with the MSRB that the level of disclosure may vary based on the issuer's financial ability to bear the risks of the recommended financing.[81] The commenter stated that a municipal entity with taxing power, who would be able to bear more risks of a financing, should not be ineligible for advice that is competent and unimpaired by the broker's own interests simply because the government can tax the citizens to restore any loss. In Response Letter II, the MSRB conceded that the financial ability to bear the risks of a recommended financing would not normally be a sufficient basis by itself for determining the level of disclosure. The MSRB noted, however, that the Interpretive Notice states three distinct factors that should be considered together in coming to this determination.

Other commenters noted that disclosure regarding derivatives is premature since there are pending rulemakings with the CFTC and the Commission that will apply to dealers recommending swaps or security-based swaps to municipal entities.[82] One commenter urged the MSRB to work together with the Commission and CFTC to ensure that one set of definitions and rules apply to the municipal securities market.[83]

In Response Letter I, the MSRB noted that it is aware of the ongoing rulemaking by the Commission and CFTC and has taken care to ensure that requirements of the Interpretive Notice are consistent with such rulemaking. In Response Letter IV, the MSRB also noted that most of the derivatives entered into by municipal securities issuers are interest rate swaps, which are within the jurisdiction of the CFTC. The MSRB noted that the provisions concerning the disclosure of material financial risks and characteristics of complex municipal securities financings have been drafted to be consistent with the CFTC's business conduct rule, which was finalized on January 11, 2012.[84]

The Commission finds that the proposed disclosures to issuers with respect to financings that the underwriter recommends are consistent with the Act because they will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest. Specifically, the Commission believes that, in providing municipal issuers with disclosures regarding the material financial characteristics and risks of certain recommended financing structures, municipal issuers should be better informed to evaluate, among other things, potential risks in selecting the financing structure most appropriate for their financing needs. The Commission also believes that issuers engaging in financings more appropriate to their needs will benefit municipal issuers, investors, and the public interest. Further, as noted by the MSRB, the required disclosures should provide issuers and their advisors with valuable information with which to evaluate underwriter recommendations and should benefit investors and the public interest.[85]

In addition, the Commission believes that it is consistent with the Act for underwriters to continue to have disclosure obligations even if the municipal issuer has retained a municipal advisor. Underwriters are in the best position to understand the material terms and risks associated with the financings that they recommend.

The Commission also believes that it is consistent with the Act to provide that underwriters must establish a reasonable belief with respect to the knowledge and experience of the issuer in determining the appropriate level of disclosures. The Commission believes that such an approach will result in disclosure more appropriately targeted to the level of the issuer's sophistication.[86] For example, to the extent that the disclosures are to a sophisticated issuer, the level of disclosure should be reduced. For a less sophisticated issuer, however, additional disclosures will help to ensure that the issuer does not proceed with a financing transaction that it otherwise would not undertake if it fully understood the material aspects of the transaction.

In addition, the Commission believes that the MSRB has adequately addressed comments regarding the disclosures for financing structures that the underwriter recommends to an issuer. Specifically, the Commission notes that in response to comments, the MSRB modified the Interpretive Notice, as originally proposed, to provide that an underwriter that recommends a complex municipal securities financing to an issuer must disclose the material financial characteristics of such complex municipal securities financing, as well as the material financial risks of such financing that are known to the underwriter and reasonably foreseeable at the time of the disclosure.[87] Also, with respect to routine financing structures, the MSRB modified the original Interpretive Notice by stating that the underwriter must provide disclosures only on the material aspects

[78] *See* SIFMA Letter I.

[79] *See id.*

[80] *See* SIFMA Letter I and SIFMA Letter III.

[81] *See* PFM Letter I.

[82] *See* SIFMA Letter I and BDA Letter I. *See also* SIFMA Letter III.

[83] *See* GFOA Letter I.

[84] In the Original Notice of Filing, the MSRB stated that it may undertake additional rulemaking as necessary to ensure consistency with Commission and CFTC rulemaking. *See* Original Notice of Filing, *supra* note 3 at 55994.

[85] *See* Response Letter III.

[86] *See* Response Letter II and Response Letter IV.

[87] According to the Interpretive Notice, as originally proposed, an underwriter that recommends a complex municipal securities financing to an issuer must disclose all material risks and characteristics of the complex municipal securities financing. The MSRB also modified the examples of the risk disclosures in the original Interpretive Notice to provide additional guidance regarding such disclosures.

of the structures that it recommends (rather than on all routine financing structures) and, only in the case of issuer personnel that the underwriter reasonably believes lack knowledge or experience with such structures.[88] Further, the Commission notes that the MSRB provided clarification with respect to the scope of the disclosure requirements and justifications for the timing of the disclosure requirements, as well as guidance regarding the types of disclosures that must be provided for complex municipal securities financings.

In addition, the Commission notes that the MSRB has committed to monitor disclosure practices by underwriters to municipal issuers and to engage in a dialogue with industry participants and the Commission to determine whether sufficient improvements have occurred in the flow of disclosures to decision-making personnel of issuers or whether additional steps should be taken to improve upon the information flow.[89]

E. Underwriter Duties in Connection With Issuer Disclosure Documents

Under the Interpretive Notice, the underwriter must have a reasonable basis for the representations and information provided to issuers in connection with the preparation by the issuer of its disclosure documents. One commenter stated its belief that the reasonable basis requirement is unreasonably broad.[90] The commenter stated that the Interpretive Notice should be revised to clarify that an underwriter may limit its responsibility for the information provided by disclosing to the issuer any limitations on the scope of its analysis and factual verification. The commenter further stated that such duty should extend only to material information. Another commenter stated its belief that when an underwriter intends to assist in the preparation of an official statement, a disclosure should be made to the issuer stating that the underwriter can only be held liable where it can be shown that it did not act with a reasonable belief that the information presented was truthful and complete.[91]

In Response Letter I, the MSRB reiterated that, in connection with materials prepared by an underwriter for use in an official statement, the underwriter must have ''a reasonable basis for the representations it makes, and other material information it provides, to an issuer'' and ''ensure that such representations and information are accurate and not misleading.'' The MSRB stated that the ''reasonable basis'' standard is based on the Commission's statement that ''[b]y participating in an offering, an underwriter makes an implied recommendation about the securities * * * this recommendation itself implies that the underwriter has a reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offerings.''[92]

The Commission finds that the dealer's duty to have a reasonable basis for the representations and material information it provides to an issuer in connection with the preparation by the issuer of its disclosure documents, and to ensure that such representations and information are accurate and not misleading, is consistent with the Act. The Commission believes that this provision will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest. The Commission also believes that the MSRB has adequately addressed the comments regarding the ''reasonable basis'' standard.

F. Underwriter Compensation and New Issue Pricing

With respect to the standard that the price an underwriter pays in a negotiated sale be fair and reasonable, one commenter stated that the standard should be altered so that the price the underwriter pays is ''not unreasonable.''[93] In the alternative, the commenter recommended that the disclosure be changed to state that although the pricing provided is fair and reasonable, it is not necessarily the best or lowest rate available.[94] Another commenter objected to the required disclosure that an underwriter must balance a fair and reasonable price for issuers with a fair and reasonable price for investors.[95] The commenter stated that there exists a reasonable price for both issuers and investors, and recommended that the disclosure be modified to reflect that statement.

In Response Letter I, the MSRB stated that the underwriter's fair and reasonable pricing duty is no different than the duties already imposed on the underwriter by MSRB rules with respect to its customers. In Response Letter II, the MSRB disagreed that underwriters should be required to provide a disclosure that the price paid to the issuer may not be the best or lowest price available because, depending on the specific pricing of a new issue, this might not be an accurate disclosure. The MSRB also stated that it is appropriate to characterize the underwriter's duties of fair pricing as a balance between the interests of the issuer and investors. In Response Letter IV, the MSRB agreed that the ''fair and reasonable'' pricing standard should not create an expectation by the issuer that the underwriter is providing the ''best pricing'' in the market and stated its belief that the disclosures under the Interpretive Notice would sufficiently address this point.

One commenter urged that underwriters be required to expressly represent in writing to the issuer that the price paid for the issuer's debt is fair, and specify the facts that support the representation.[96] This commenter stated that according to the MSRB, the underwriter's own judgment as to what is fair is an independent component of ''fairness'' and that the MSRB hedged the protection of an issuer ''by adhering to its earlier, pre-Dodd-Frank expression of the principle that 'whether an underwriter has dealt fairly with an issuer'—the command of Rule G–17—depends on all 'the facts and circumstances' and is not dependent solely on the price of the issue.''

In Response Letter II, the MSRB stated that its long-standing view that whether an underwriter has dealt fairly with an issuer for purposes of Rule G–17 is dependent upon all of the facts and circumstances of an underwriting, and

[88] The Interpretive Notice, as originally proposed, stated that in the case of issuer personnel that lack knowledge or experience with routine financing structures, the underwriter must provide disclosures on the material aspects of such structures.

[89] *See* Response Letter II. *See also* Response Letter IV.

[90] *See* SIFMA Letter I.

[91] *See* NAIPFA Letter I.

[92] *See* Original Notice of Filing, 76 FR at 55992 (quoting Securities Exchange Act Release No. 26100 (September 22, 1988), 53 FR 37778, 37787 (September 28, 1988) (proposing Exchange Act Rule 15c2–12)). The MSRB stated that it would be a curious result for the underwriter not to be required under Rule G–17 to have a reasonable basis for its own representations set forth in the official statement, as well as a reasonable basis for the material information it provides to the issuer in connection with the preparation of the official statement. *See* Original Notice of Filing, 76 FR at 55992. *See also* Response Letter IV.

[93] *See* NAIPFA Letter I and NAIPFA Letter II.

[94] *See* NAIPFA Letter II. This commenter subsequently clarified this comment and stated its belief that the ''fair and reasonable'' standard should not create an expectation that the underwriter is providing the ''best pricing'' in the market. *See* NAIPFA Letter III. The commenter also stated that ''the determinate of 'best pricing' cannot be made by the underwriter whose conflicts of interest in this regard greatly outweigh any objectivity that an underwriter may have in regard to the pricing they have provided.'' *Id.*

[95] *See* BDA Letter II.

[96] *See* PFM Letter I.

not solely on the price of the issue, enhances issuer protection, and that the commenter had misunderstood its meaning. The MSRB further stated that even if an underwriter provides a fair price to an issuer for its new issue offering, its fair practice duties under Rule G–17 are not thereby discharged because, among other things, the many principles laid out in the Interpretive Notice also must be addressed. Conversely, an underwriter cannot justify under Rule G–17 an unfair price to an issuer by balancing that unfair price with the fact that it may otherwise have been fair to the issuer under the other fairness principles enunciated in the Interpretive Notice.

The Commission finds that the proposed standard with respect to new issue pricing is consistent with the Act because it will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest. Specifically, the Commission notes that the Interpretive Notice would provide that the duty of fair dealing under Rule G–17 includes an implied representation that the price an underwriter pays to an issuer is fair and reasonable. The Commission also believes that the MSRB has adequately addressed the comments on new issue pricing by clarifying the underwriter's duty and required disclosures with respect to such pricing.

In addition, the Commission finds that the proposed provision with respect to excessive compensation is consistent with the Act because it will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest. For example, the Interpretive Notice would remind underwriters that compensation for a new issue could be so disproportionate to the nature of the underwriting and related services performed as to constitute an unfair practice with respect to the issuer, and as such a violation of Rule G–17.

G. Conflicts of Interest

1. Payments To or From Third Parties

One commenter suggested that the disclosure requirement with respect to payments to or from third parties is too broad.[97] The commenter stated its belief that ''the intent of G–17 is that payments to those who carry some level of influence with an issuer and who have advocated on the underwriter's behalf in securing municipal securities business must be disclosed,'' but the proposed requirement ''may be interpreted to encompass a broad array of other professional services that happen in the standard course of municipal securities business.'' [98] In Response Letter II, the MSRB clarified that the third-party payments to which the disclosure requirement would apply are those that give rise to actual or potential conflicts of interest, and the disclosure requirement typically would not apply to third-party arrangements for products and services of the type that are routinely entered into in the normal course of business, so long as any specific routine arrangement does not give rise to an actual or potential conflict of interest.

One commenter stated that disclosures with respect to third-party arrangements for the marketing of the issuer's securities should be clarified as to the level of details.[99] Further, the commenter stated that payments to and from affiliates of the underwriters are not third-party payments since payments would not color a party's judgment when the parties are related to each other, unlike third parties. In Response Letter I, while the MSRB disagreed with the comment that payments from affiliates do not raise risks, the MSRB noted that the Interpretive Notice, as modified by Amendment No. 2, would not require disclosure of the amount of third-party payments. In addition, in Response Letter III, the MSRB stated its belief that ''it is essential that issuers and their advisors understand the conflicts of interest that might color underwriter recommendations.'' [100]

Another commenter stated that the payment amount is an important variable for the issuer to consider and that it would encourage its members to further question the underwriter about any relevant third-party relationships and payments, which would provide better transparency for the transaction.[101] In Response Letter II, the MSRB agreed that such further inquiries could be made. In Response Letter IV, the MSRB noted that the purpose of the third-party payment disclosure is to draw them to the issuer's attention, and the issuer may then request additional information about such payments as it considers appropriate.

The Commission finds that the proposed disclosure with respect to the existence of payments to or from third parties is consistent with the Act because the disclosure will notify the issuer of potential conflicts of interest, even though underwriters need not disclose the amount of such payments. As such, the Commission believes that the disclosure will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest.

In addition, the Commission believes that the MSRB has adequately addressed the comments regarding the disclosure of third-party payments by providing clarification with respect to the scope of the disclosure, the information required to be disclosed, and justifications for the disclosure. Specifically, the Commission notes that in response to comments, the MSRB modified the Interpretive Notice, as originally proposed, by stating that the underwriter is not required to disclose the amount of third-party payments, but rather only the existence of such payments. The MSRB also modified the original Interpretive Notice by providing that an underwriter must only disclose whether it has entered into any third-party arrangements for the marketing of the issuer's securities. Further, in response to comments, the MSRB deleted the statements in the original Interpretive Notice that the underwriter must disclose the purpose of the third-party payment, the name of the party making or receiving the payment, and details of third-party arrangements for the marketing of the issuer's securities. In addition, the MSRB stated that it will monitor whether the proposal has achieved the effect of providing issuers

[97] *See* IA Letter.

[98] *Id.*

[99] *See* SIFMA Letter I.

[100] Specifically, in Response Letter III, the MSRB stated that: ''Municipal securities offerings borne of self-interested advice or in the context of conflicting interests or undisclosed payments to third parties are much more likely to be the issues that later experience financial or legal stress or otherwise perform poorly as investments, resulting in significant harm to investors and issuers, including increased costs to taxpayers.'' The MSRB also noted that in recent years, a series of state and federal proceedings involving undisclosed third-party payments in connection with new issues of municipal securities or closely-related transactions have been instituted. According to the MSRB, in at least one case, such undisclosed third-party payments allegedly occurred in connection with activities that may have contributed to the bankruptcy in Jefferson County, Alabama. In addition, the MSRB noted that the U.S. Department of Justice, the Commission, and the attorneys general of a number of states have pursued criminal and civil cases involving allegedly fraudulent activities relating to municipal securities offerings and closely-related transactions in which undisclosed third-party payments have played an important role in carrying out the allegedly fraudulent activities.

[101] *See* GFOA Letter II. *See also* GFOA Letter III. In Response Letter IV, the MSRB stated that it would monitor whether disclosure of the amounts should be required.

with adequate information about actual or potential material conflicts of interest and whether the amount of third-party payments or other additional information should be required.[102]

2. Profit-Sharing With Investors

One commenter sought clarification that legitimate trading, such as when an underwriter sells a bond and later repurchases the bond from a purchaser, is not included in the disclosure requirement for profit sharing arrangements.[103] In Response Letter II, the MSRB stated that the language of the proposal appropriately reflects that the disclosure applies in cases where there exists an arrangement to split or share profits realized by an investor upon resale.

The Commission finds that the proposed provision with respect to profit-sharing arrangements with investors is consistent with the Act because it will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest. For example, the Interpretive Notice would clarify that such arrangements could constitute a violation of an underwriter's fair dealing obligation under Rule G–17, or a violation of Rule G–25(c), which precludes a dealer from sharing in the profits or losses of a transaction in municipal securities with or for a customer.

3. Credit Default Swaps

One commenter expressed support for the disclosure of an underwriter's credit default swap position as it relates to the issuer and the financing.[104] Another commenter stated its belief that the disclosure of underwriters' hedging and risk management activities could unduly deter the use of credit default swaps for risk management and could potentially compromise counterparty relationships.[105] The commenter noted that should these disclosures be required, generalized disclosures that put the issuer on notice of the possibility that the underwriter may, from time to time, engage in such dealings, should be sufficient. The commenter objected to any provision that would require underwriters to provide specific disclosures that could reveal counterparty information or the underwriters' hedging and risk management strategies. In Response Letter I, the MSRB stated that the disclosure requirement would not compromise counterparty relationships or deter the use of credit default swaps for legitimate risk management purposes. Specifically, the MSRB noted that the amended Interpretive Notice would only require a dealer that engages in the issuance or purchase of a credit default swap for which the underlying reference is an issuer for which the dealer is serving as underwriter, or an obligation of that issuer, to disclose the fact that it does so to the issuer, and not the terms of the particular trades.[106]

The Commission finds that the proposed disclosure requirements with respect to credit default swaps where the reference is the issuer for which the dealer is serving as underwriter, or an obligation of that issuer, are consistent with the Act. The Commission believes that the disclosures will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest by bringing to the issuer's attention a potential conflict of interest with the underwriter. As noted by the MSRB, the disclosure of potential or actual material conflicts of interest could help issuers and their advisors to understand the conflicts of interest that might color underwriter recommendations.[107] Further, the Commission does not believe that the disclosures will deter the use of credit default swaps for risk management purposes or compromise counterparty relationships because, while a dealer would be required to disclose that it engages in credit default swaps to the issuer for which it serves as an underwriter, it would not be required to disclose the details of such swaps.

In addition, the Commission believes that the MSRB has adequately addressed the comments regarding the disclosure of credit default swaps by providing clarification with respect to the scope of the disclosure. Specifically, the Commission notes that in response to comments, the MSRB modified the Interpretive Notice, as originally proposed, by clarifying that a dealer must only disclose the fact that it engages in such credit default swaps to the issuer for which it serves as underwriter.[108]

H. Retail Order Periods

One commenter recommended that the Interpretive Notice use a single standard of requiring that the underwriter not knowingly accept orders that do not meet the requirements of the retail order period.[109] In Response Letter II, the MSRB stated that it believes that the commenter misunderstood these provisions. According to the MSRB, the Interpretive Notice provides that an underwriter that knowingly accepts an order that has been framed as a retail order when it is not would violate MSRB Rule G–17 if its actions are inconsistent with the issuer's expectations regarding retail orders, but also provides that a dealer that places an order that is framed as a qualifying retail order but that in fact represents an order that does not meet the qualification requirements to be treated as a retail order, would violate its duty of fair dealing. In Response Letter II, the MSRB stated that these two provisions are entirely consistent and appropriate, since in the first provision an underwriter is receiving an order framed by a third party, whereas in the second provision, a dealer (not limited to an underwriter) is itself placing and framing the order. Therefore, the MSRB noted that it has not modified these provisions.

The Commission finds that the proposed provisions regarding retail order periods are consistent with the Act. The Commission believes that the provisions will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest by helping to ensure that the underwriter complies with its Rule G–17 duty of fair dealing in a transaction with a retail order

[102] *See* Response Letter IV.

[103] *See* BDA Letter II.

[104] *See* GFOA Letter II. *See also* GFOA Letter III.

[105] *See* SIFMA Letter I.

[106] One commenter stated that the Interpretive Notice provides that if a dealer issues or purchases credit default swaps for which the reference obligor is the issuer to which the dealer is serving as an underwriter, the underwriter must disclose that fact to the issuer. *See* SIFMA Letter II. This commenter stated that, in the case of a conduit issuer that issues bonds for multiple obligors or with respect to a specific project or revenue stream, any disclosure regarding credit default swaps needs to be made solely to the obligor or obligors that are obligated with respect to the securities transaction being underwritten by the underwriter. In Response Letter II, the MSRB stated that the proposal only requires that credit default swap disclosures be made to the issuers of the municipal securities and not to any conduit borrowers or other obligors. However, the MSRB stated that it would take under advisement the question of whether such disclosure should be extended to any applicable obligors other than the issuer.

[107] *See* Response Letter III.

[108] The original Interpretive Notice stated that Rule G–17 requires that a dealer who engages in such credit default swaps disclose that to the issuers for which it serves as underwriter. In its discussion of the exemption for credit default swaps on baskets or indexes of municipal issuers that include the issuer or its obligations, the MSRB replaced the words ''trades in credit default swaps'' with ''[a]ctivities with regard to credit default swaps.''

[109] *See* BDA Letter II.

period. For example, the Interpretive Notice would state that Rule G–17 requires an underwriter that has agreed to underwrite a transaction with a retail order period to honor such agreement and to take reasonable measures to ensure that retail clients are bona fide. In addition, the Commission believes that the MSRB has adequately addressed the comment regarding the requirements for retail order periods by providing clarification with respect to the activities that could be considered violations of Rule G–17.

I. Dealer Payments to Issuer Personnel

One commenter requested that, in the absence of disclosure and informed consent, underwriters be prohibited from seeking reimbursements from bond proceeds for expenditures made on behalf of the issuer for any expenses incurred by the underwriter.[110] The commenter also requested that underwriters provide disclosure to issuers that ''[e]xpenses made in connection with the issuance of securities were incurred by the underwriter on behalf of the issuer, but that the issuer is under no obligation to issue additional bonds to reimburse the underwriter for these expenditures.'' [111] In Response Letter I, the MSRB stated that it is unreasonable to require underwriters to disclose to issuers that they are under no obligation to reimburse the underwriter from bond proceeds for expenditures made on behalf of the issuer. The MSRB noted that Rule G–20 already precludes underwriters from seeking reimbursement for lavish expenditures, especially from bond proceeds, and that various state laws also address whether such reimbursements are permissible.

The Commission finds that the proposed provisions regarding dealer payments to issuer personnel are consistent with the Act. The Commission believes that the provisions will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, municipal entities, and the public interest by reminding dealers of the application of MSRB Rules G–20 and G–17 in connection with certain payments made to, and expenses reimbursed for, issuer personnel during the municipal bond issuance process. The Commission also believes that the MSRB has adequately addressed the comments with respect to dealer payments to issuer personnel by clarifying the laws and rules that govern such payments.

J. Timing and Consistency

One commenter noted that underwriters that may also be municipal advisors will not be able to properly evaluate the Interpretive Notice until rules with respect to municipal advisors have been approved and adopted by the Commission and the MSRB.[112] The commenter stated that, given the withdrawal of the MSRB's rule proposals with respect to municipal advisors, the requirements that will be applicable to underwriters that are also municipal advisors are unknown.[113] The commenter suggested that underwriters may ultimately become subject to duplicative or inconsistent obligations for the same or similar activities. The commenter also stated that many interested parties are abstaining from commenting on the proposal due to this uncertainty. In Response Letter IV, the MSRB noted that two commenters supported the Commission's approval of the proposed rule change even though the Commission's rulemaking on the definition of ''municipal advisor'' remains pending.[114] The MSRB also noted that one commenter stated that it could ''find no rational correlation between a delay in the adoption of the [Interpretive Notice] and the adoption of a definition of 'municipal advisor'.'' [115]

One commenter stated that because the Interpretive Notice would obligate underwriters to comply with detailed and specific requirements to which they are not currently subject, the 90-day implementation period is too short and requested a period of no less than six months.[116] In Response Letter I, the MSRB stated that it believes that 90 days is an adequate time period for underwriters to develop the required disclosures, especially as noted by the commenter, ''underwriters who follow best practices in their dealings with municipal issuers already engage in an open dialogue with the issuers concerning the risks of the transactions being underwritten.'' [117]

The Commission finds that the timing of the proposed rule change is consistent with the Act. As discussed above, the Commission believes that the disclosures specified in the Interpretive Notice will benefit municipal issuers, including helping municipal issuers to better understand the role of the underwriter, and to better evaluate potential risks in engaging a particular underwriter and in selecting the financing structure most appropriate for their financing needs. Such disclosures should, in turn, benefit investors and the public interest. The MSRB also noted that the required disclosures should provide issuers and their advisors with valuable information with which to evaluate underwriter recommendations.[118] In addition, the Commission does not believe that approval of the proposed rule change should be delayed pending rulemaking with respect to municipal advisors because, as noted by one commenter, the provisions of the Interpretive Notice would govern the conduct of underwriters and not the conduct of municipal advisors.[119] With respect to commenters' concerns about potential duplication or inconsistency between the requirements applicable to underwriters and the requirements applicable to underwriters that are also municipal advisors, the Commission notes that any proposal by the MSRB interpreting the application of MSRB Rule G–17 to municipal advisors must be filed with, and considered by, the Commission pursuant to Section 19(b) of the Exchange Act [120] before the proposal can become effective.

The Commission also believes that the 90-day implementation period is consistent with the Act and notes that, as stated by one commenter, underwriters may already provide issuers with some of the required disclosures to the extent such underwriters are already following best practices in their dealings with issuers.[121]

K. Other Comments

One commenter requested clarification that the proposal is not intended to apply to private placement agents.[122] In Response Letter II, the MSRB stated that, given the nature of the proposed role disclosures and in light of the characteristics of a ''true private placement'' of municipal securities, those elements of the role disclosures that would not be applicable to a true private placement would not be

[110] *See* NAIPFA Letter I. *See also* NAIPFA Letter III. *But see* SIFMA Letter III.

[111] NAIPFA Letter I.

[112] *See* SIFMA Letter I; SIFMA Letter II; and SIFMA Letter III. *See also* BDA Letter III. Another commenter, however, stated that the proposal should not be dependent on the definition of municipal advisor and urged the Commission to approve the proposal. *See* NAIPFA Letter III. *See also* GFOA Letter III.

[113] *See* SIFMA Letter I.

[114] *See, e.g.,* GFOA Letter III and NAIPFA Letter III.

[115] NAIPFA Letter III.

[116] *See* SIFMA Letter I. *See also* SIFMA Letter III.

[117] SIFMA Letter I. *See also* Response Letter IV.

[118] *See* Response Letter III.

[119] *See* NAIPFA Letter III.

[120] 15 U.S.C. 78s(b).

[121] *See* SIFMA Letter I.

[122] *See* SIFMA Letter II.

required to be included in the disclosures made in connection with a dealer serving as placement agent for a new issue. The MSRB stated, however, that Rule G–17, and the remaining provisions of the Interpretive Notice, would continue to apply.[123] The Commission believes that the MSRB has adequately addressed the comment on the application of the Interpretive Notice to private placement agents by providing clarification with respect to the application of Rule G–17 and the Interpretive Notice to private placement agents.

One commenter urged further consideration of the costs of the disclosures and weighing of the costs against the potential benefits.[124] In Response Letter II, the MSRB noted its disagreement that it did not weigh the costs and benefits. The MSRB noted that the Interpretive Notice ''recognizes that there is significant variability of size, sophistication and frequency of accessing the market among issuers across the country, and many of the disclosures required under the Proposal can be tailored, and in some cases are not required at all, based on a number of relevant factors set out in the Proposal.'' Further, the MSRB stated that although it recognizes that some underwriters may bear up-front costs in creating basic frameworks for the required disclosures for the various types of products they may offer their issuer clients, the on-going burden should thereafter be considerably reduced and the preparation of written disclosures would become an inter-related component of the necessary documentation of the transaction.[125] In Response Letter II, the MSRB also noted that providing more information to issuers would empower and provide considerable benefits to issuers.

In addition, in Response Letter III, the MSRB noted that the disclosures with respect to the role of the underwriter and actual or potential conflicts of interest could consist of the language provided in the Interpretive Notice, which would lessen the potential costs associated with the disclosures. Moreover, the MSRB stated that disclosures with respect to the risks of a proposed financing would not burden underwriters greatly as generally only complex financings would require such disclosures. For routine financings, the MSRB stated that disclosures would only be required if the issuer personnel lacked knowledge or expertise.

In Response Letter III, the MSRB emphasized its belief regarding the benefits of the proposed disclosures. First, the MSRB stated that municipal securities offerings that result from self-interested advice, conflicting interest or undisclosed payments to third-parties are more likely to encounter issues at a later date, which could cause harm to investors and issuers. Thus, the MSRB believes that the proposed disclosures would help address such practices. Second, the MSRB stated that municipal issuers have entered into complex financings that later created serious risks to the municipalities and that the burden on underwriters of the required disclosures would be outweighed by the benefits to issuers in avoiding similar situations in the future.

The Commission believes that the MSRB has adequately addressed comments regarding the costs resulting from the Interpretive Notice.[126] The Commission appreciates that the proposed rule change will impose costs upon underwriters, but believes such costs are justified by the benefits that will result from the Interpretive Notice.[127] As noted above, the Commission believes that the required disclosures will benefit municipal issuers by providing them with valuable information with which to evaluate, among other things, the potential risks of engaging a particular underwriter and entering into a recommended financing structure. The Commission also believes that the disclosures would benefit investors and the public interest.

As noted by the MSRB in Response Letter III, there may be additional up-front costs in creating basic frameworks for the disclosures, but many of the disclosures could be standardized. The Commission believes that such standardization will help reduce the ongoing burden of preparing the written disclosures.[128] In addition, to help further reduce the potential costs associated with the proposed disclosures, the Commission notes that the Interpretive Notice contains language that underwriters may incorporate into their written disclosures, such as language in the Interpretive Notice regarding the underwriter's role and the conflict of interest caused by contingent fee compensation.

Further, as noted above, in response to comments, the MSRB made modifications to the Interpretive Notice, as originally proposed, which it believes will help reduce the cost of compliance.[129] For example, under the amended Interpretive Notice, an underwriter that recommends a complex municipal securities financing to an issuer must disclose the material financial characteristics of such complex municipal securities financing, as well as the material financial risks of such financing that are known to the underwriter and reasonably foreseeable at the time of the disclosure, as opposed to all material risks and characteristics of the financing.

IV. General Commission Findings

As noted above, the Commission has carefully considered the proposed rule change, as modified by Amendment No. 2, the comment letters received, and the MSRB's responses. For the reasons discussed above, the Commission finds that the proposed rule change, as modified by Amendment No. 2, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the MSRB. Specifically, the Commission finds that the proposed rule change is consistent with the provisions of Section 15B(b)(2)(C) of the Act.[130]

The Commission believes that, in general, the MSRB has adequately responded to the comments received on the proposed rule change. The Commission also notes that the MSRB has stated that it will monitor disclosure practices under the Interpretive Notice and will engage in a dialogue with industry participants and the Commission to determine whether sufficient improvements have occurred in the flow of the disclosures to decision-making personnel of issuers or whether additional steps should be

[123] In Response Letter II, the MSRB also reminded dealers to remain cognizant of the fact that the circumstances under which a true private placement may arise in the municipal market are quite constrained.

[124] *See* SIFMA Letter I; SIFMA Letter II; and SIFMA Letter III. Other commenters stated their belief that the proposed disclosures will not cause undue costs or burdens to underwriters. *See* PFM Letter II and GFOA Letter III.

[125] *See also* Response Letter III.

[126] In approving this proposed rule change, the Commission has also considered whether the proposed change will promote efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f). While none of the commenters specifically commented on efficiency, competition, and capital formation, some of the comments raised concerns about the burdens imposed by the proposed rule change and possible effects on certain transactions. As discussed above, the additional disclosures required by the proposed rule change are intended to deter fraud, inform issuers about potential conflicts of interest, and help to ensure that municipal entities engage in financings appropriate to their needs.

[127] *See* Response Letter III.

[128] The MSRB stated that standardized disclosures could be developed to describe common material financial risks and characteristics that would then only need to be modified in the event of variants in the structures proposed by the underwriter.

[129] *See* Response Letter III.

[130] 15 U.S.C. 78*o*–4(b)(2)(C).

taken.[131] The MSRB also stated that it will monitor matters relating to the timing of disclosures in order to determine whether any further action in this area is merited.[132] In addition, the MSRB stated that it will monitor whether the proposal has achieved the effect of providing issuers with adequate information about actual or potential material conflicts of interest and whether the amount of third-party payments or other additional information should be required.[133]

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[134] that the proposed rule change (SR–MSRB–2011–09), as modified by Amendment No. 2, be, and it hereby is, approved.

By the Commission.

Elizabeth M. Murphy,

Secretary.

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[131] *See* Response Letter II and Response Letter IV.

[132] *See* Response Letter II.

[133] *See* Response Letter IV.

[134] 15 U.S.C. 78s(b)(2).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–66926; File No. SR–Phlx–2012–56]

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Modify Phlx's Fee Schedule Governing Routing From Its NASDAQ OMX PSX Facility

May 4, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1], and Rule 19b–4 thereunder,[2] notice is hereby given that on April 26, 2012, NASDAQ OMX PHLX LLC (''Phlx'' or ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to modify Phlx's fee schedule governing routing from its NASDAQ OMX PSX (''PSX'') facility. Phlx will implement the change on May 1, 2012. The text of the proposed rule change is available on the Exchange's Web site at *http://nasdaqtrader.com/micro.aspx?id=PHLXRulefilings,* at the principal office of the Exchange, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

Phlx is making a minor modification to the schedule governing fees for use of the routing services of its PSX facility. Specifically, for PSCN [3] and PSTG [4] orders that execute at NASDAQ OMX BX (''BX''), Phlx currently charges $0.0027 per share executed. However, because BX currently pays a rebate with respect to orders that access liquidity, Phlx is proposing to replace the fee with a credit equal to the $0.0014 per share executed credit paid by BX. The change is intended to encourage greater use of the routing facilities of PSX.

2. Statutory Basis

Phlx believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,[5] in general, and with Sections 6(b)(4) and (5) of the Act,[6] in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system which Phlx operates or controls, and is not designed to permit unfair discrimination between customers, issuers, brokers or dealers. All similarly situated members are subject to the same fee structure, and access to Phlx is offered on fair and non-discriminatory terms. The change is reasonable because the proposed credit is equal to the credit paid by BX with respect to orders that it executes. The change is consistent with an equitable allocation of fees because it will bring the economic attributes of using the PSCN and PSTG routing strategies in line with the cost of executing orders at BX. Finally, the change is not unfairly discriminatory because it solely applies to members that opt to use the PSCN and PSTG routing strategies.

Finally, Phlx notes that it operates in a highly competitive market in which market participants can readily favor competing venues if they deem fee levels at a particular venue to be excessive. In such an environment, Phlx must continually adjust its fees to remain competitive with other exchanges and with alternative trading systems that have been exempted from compliance with the statutory standards applicable to exchanges. Phlx believes that the proposed rule change reflects this competitive environment because it is designed to create pricing incentives for greater use of the PSX routing facility.

B. Self-Regulatory Organization's Statement on Burden on Competition

Phlx does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. Because the market for order execution is extremely competitive, members may readily opt to disfavor Phlx's execution services if they believe that alternatives offer them better value. The proposed change is designed to enhance competition by using pricing incentives to encourage greater use of the PSX routing facility.

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] PSCN is a routing option under which orders check the System for available shares and then are sent to destinations on the System routing table. If shares remain unexecuted after routing, they are posted on the book. Once on the book, should the order subsequently be locked or crossed by another market center, the System will not route the order to the locking or crossing market center. PSKP is a form of PSCN in which the entering firm instructs the System to bypass any market centers included in the PSCN System routing table that are not posting Protected Quotations within the meaning of Regulation NMS.

[4] PSTG is a routing option under which orders check the System for available shares and then are sent to destinations on the System routing table. If shares remain unexecuted after routing, they are posted on the book. Once on the book, should the order subsequently be locked or crossed by another accessible market center, the System shall route the order to the locking or crossing market center. PSKN is a form of PSTG in which the entering firm instructs the System to bypass any market centers included in the PSTG System routing table that are not posting Protected Quotations within the meaning of Regulation NMS.

[5] 15 U.S.C. 78f.

[6] 15 U.S.C. 78f(b)(4) and (5).