Rule 24.20(b)(2) provides a member with a limited amount of time, two hours from the time of the originally quoted prices, within which to execute the SPX Combo Order. In addition, the prices originally quoted for the SPX Combo Order must satisfy the requirements of CBOE Rule 24.20(b)(1), which provides, among other things, that the order must be quoted so that no leg of the order would trade at a price outside the currently displayed bids or offers in the trading crowd or bids or offers in the SPX limit order book.[23] The Commission believes that CBOE Rule 24.20(b)(2) will provide market participants with flexibility to execute SPX Combo Orders and may help market participants to hedge positions in SPX options during times of market volatility.

The Commission finds that CBOE Rule 24.20(b)(1) clarifies the procedures that a member holding an SPX Combo Order must follow. The procedures specified in CBOE Rule 24.20(b)(1) are the same as the procedures set forth in CBOE Rule 6.45(e) and, accordingly, do not raise new regulatory issues.[24]

Each component series of an out-of-range SPX Combo Order will be price reported to the CBOE's trading floor and to OPRA with an indicator that will provide notice to the public that the reported prices were part of an out-of-range SPX Combo Order trade. The Commission believes that the indicator should help to avoid investor confusion regarding out-of-range SPX Combo Order trades and minimize any negative impact on price discovery. In addition, the indicator should help the CBOE to monitor the trading of SPX Combo Orders.

The Commission believes that that the CBOE has adopted surveillance procedures that are adequate to monitor compliance with the requirements of CBOE Rule 24.20.

Finally, the Commission notes that in its regulatory circular to members explaining the operation of CBOE Rule 24.20, the CBOE will remind its members that the adoption of CBOE Rule 24.20 does not diminish the obligation of CBOE members to obtain best execution for their customers.[25]

[23] Telephone conversation between Jaime Galvan, Attorney, Legal Division, CBOE, and Yvonne Fraticelli, Special Counsel, Division, Commission, on November 28, 2001.

[24] In addition, CBOE Rule 24.19, ''OEX-SPX Spread Orders,'' contains similar requirements for members holding OEX-SPX spread orders.

[25] *See* Amendment No. 1, *supra* note 3.

Accelerated Approval of Amendment Nos. 1, 2, 3, and 4

The Commission finds good cause for approving Amendment Nos. 1, 2, 3, and 4 prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 1 strengthens the CBOE's proposal by limiting the time for executing an out-of-range SPX Combo Order to two hours after the time of the original quotes. Amendment No. 2 clarifies the CBOE's proposal by providing consistent numbering in paragraphs (a) and (b) of CBOE Rule 24.20. Amendment No. 3 strengthens the CBOE's proposal by adopting the requirements in CBOE Rule 24.20(b)(1) for members holding SPX Combo Orders. Amendment No. 4 strengthens the proposal by clarifying the definitions of ''SPX combination,'' ''delta,'' and ''SPX Combo Order.'' Accordingly, the Commission finds that there is good cause, consistent with Sections 6(b)(5) and 19(b) of the Act,[26] to approve Amendment Nos. 1, 2, 3, and 4 on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 1, 2, 3, and 4, including whether Amendment Nos. 1, 2, 3, and 4 are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to file number SR-CBOE–00–40 and should be submitted by March 4, 2002.

V. Conclusion

It Is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,[27] that the proposed rule change (SR–CBOE–00–40), as amended, is approved.

[26] 15 U.S.C. 78f(b)(5) and 78s(b).

[27] 15 U.S.C. 78s(b)(2).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[28]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02–3231 Filed 2–8–02; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45364; File No. SR–MSRB–2002–02]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Transactions With Sophisticated Municipal Market Professionals

January 30, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''the Act'')[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on January 25, 2002, the Municipal Securities Rulemaking Board (''MSRB'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the MSRB. 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

Interpretive Notice Regarding Sophisticated Municipal Market Professionals IntroductionIndustry participants have suggested that the MSRB's fair practice rules should allow dealers[3] to recognize the different capabilities of certain institutional customers as well as the varied types of dealer-customer relationships. Prior MSRB interpretations reflect that the nature of the dealer's counter-party should be considered when determining the specific actions a dealer must undertake to meet its duty to deal fairly. The MSRB believes that dealers may consider the nature of the institutional customer in determining what specific actions are necessary to meet the fair practice standards for a particular transaction. This interpretive notice

[28] 17 CFR 200.30–3(a)(12).

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

[2] 17 CFR 240.19–4.

[3] The term ''dealer'' is used in this notice as shorthand for ''broker,'' ''dealer'' or ''municipal securities dealer,'' as those terms are defined in the Act. The use of the term in this notice does not imply that the entity is necessarily taking a principal position in a municipal security.

concerns only the manner in which a dealer determines that it has met certain of its fair practice obligations to certain institutional customers; it does not alter the basic duty to deal fairly, which applies to all transactions and all customers. For purposes of this interpretive notice, an institutional customer shall be an entity, other than a natural person (corporation, partnership, trust, or otherwise), with total assets of at least $100 million invested in municipal securities in the aggregate in its portfolio and/or under management.

Sophisticated Municipal Market Professionals

Not all institutional customers are sophisticated regarding investments in municipal securities. There are three important considerations with respect to the nature of an institutional customer in determining the scope of a dealer's fair practice obligations. They are:

- Whether the institutional customer has timely access to all publicly available material facts concerning a municipal securities transaction;
- Whether the institutional customer is capable of independently evaluating the investment risk and market value of the municipal securities at issue; and
- Whether the institutional customer is making independent investment decisions about its investments in municipal securities.

When a dealer has reasonable grounds for concluding that an institutional customer (i) has timely access to the publicly available material facts concerning a municipal securities transaction; (ii) is capable of independently evaluating the investment risk and market value of the municipal securities at issue; and (iii) is making independent decisions about its investments in municipal securities, and other known facts do not contradict such a conclusion, the institutional customer can be considered a sophisticated municipal market professional (''SMMP''). While it is difficult to define in advance the scope of a dealer's fair practice obligations with respect to a particular transaction, as will be discussed later, by making a reasonable determination that an institutional customer is an SMMP, then certain of the dealer's fair practice obligations remain applicable but are deemed fulfilled. In addition, as discussed below, the fact that a quotation is made by an SMMP would have an impact on how such quotation is treated under Rule G–13.

Considerations Regarding The Identification Of Sophisticated Municipal Market Professionals

The MSRB has identified certain factors for evaluating an institutional investor's sophistication concerning a municipal securities transaction and these factors are discussed in detail below. Moreover, dealers are advised that they have the option of having investors attest to SMMP status as a means of streamlining the dealers' process for determining that the customer is an SMMP. However, a dealer would not be able to rely upon a customer's SMMP attestation if the dealer knows or has reason to know that an investor lacks sophistication concerning a municipal securities transaction, as discussed in detail below.

Access to Material Facts

A determination that an institutional customer has timely access to the publicly available material facts concerning the municipal securities transaction will depend on the customer's resources and the customer's ready access to established industry sources (as defined below) for disseminating material information concerning the transaction. Although the following list is not exhaustive, the MSRB notes that relevant considerations in determining that an institutional customer has timely access to publicly available information could include:

- The resources available to the institutional customer to investigate the transaction (*e.g.*, research analysts);
- The institutional customer's independent access to the NRMSIR system,[4] and information generated by the MSRB's Municipal Securities Information Library® (MSIL®) system [5] and Transaction Reporting System (''TRS''),[6] either directly or through services that subscribe to such systems; and
- The institutional customer's access to other sources of information concerning material financial developments affecting an issuer's securities (e.g.., rating agency data and indicative data sources).

Independent Evaluation of Investment Risks and Market Value

Second, a determination that an institutional customer is capable of independently evaluating the investment risk and market value of the municipal securities that are the subject of the transaction will depend on an examination of the institutional customer's ability to make its own investment decisions, including the municipal securities resources available to the institutional customer to make informed decisions. In some cases, the dealer may conclude that the institutional customer is not capable of independently making the requisite risk and valuation assessments with respect to municipal securities in general. In other cases, the institutional customer may have general capability, but may not be able to independently exercise these functions with respect to a municipal market sector or type of municipal security. This is more likely to arise with relatively new types of municipal securities and those with significantly different risk or volatility characteristics than other municipal securities investments generally made by the institution. If an institution is either generally not capable of evaluating investment risk or lacks sufficient capability to evaluate the particular municipal security, the scope of a dealer's fair practice obligations would not be diminished by the fact that the dealer was dealing with an institutional customer. On the other hand, the fact that a customer initially needed help understanding a potential investment need not necessarily imply that the customer did not ultimately develop an understanding and make an independent investment decision.

[4] For purposes of this notice, the ''NRMSIR system'' refers to the disclosure dissemination system adopted by the Commission in Rule 15c2–12. Under Rule 15c2–12, as adopted in 1989, participating underwriters provide a copy of the final official statement to a Nationally Recognized Municipal Securities Information Repository (''NRMSIR'') to reduce their obligation to provide a final official statement to potential customers upon request. In the 1994 amendments to Rule 15c2–12, the Commission determined to require that annual financial information and audited financial statements submitted in accordance with issuer undertakings be delivered to each NRMSIR and to the State Information Depository (''SID'') in the issuer's state, if such depository has been established. The requirement to have annual financial information and audited financial statements delivered to all NRMSIRs and the appropriate SID was included in Rule 15c2–12 to ensure that all NRMSIRs receive disclosure information directly. Under the 1994 amendments, notices of material events, as well as notices of a failure by an issuer or other obligated person to provide annual financial information, must be delivered to each NRMSIR or the MSRB, and the appropriate SID.

[5] The MSIL® system collects and makes available to the marketplace official statements and advance refunding documents submitted under MSRB Rule G–36, as well as certain secondary market material event disclosures provided by issuers under SEC Rule 15c2–12. Municipal Securities Information Library® and MSIL® are registered trademarks of the MSRB.

[6] The MSRB's TRS collects and makes available to the marketplace information regarding inter-dealer and dealer-customer transactions in municipal securities.

While the following list is not exhaustive, the MSRB notes that relevant considerations in determining that an institutional customer is capable of independently evaluating investment risk and market value considerations could include:

- The use of one or more consultants, investment advisers, research analysts or bank trust departments;
- The general level of experience of the institutional customer in municipal securities markets and specific experience with the type of municipal securities under consideration;
- The institutional customer's ability to understand the economic features of the municipal security;
- The institutional customer's ability to independently evaluate how market developments would affect the municipal security that is under consideration; and
- The complexity of the municipal security or securities involved.

Independent Investment Decisions

Finally, a determination that an institutional customer is making independent investment decisions will depend on whether the institutional customer is making a decision based on its own thorough independent assessment of the opportunities and risks presented by the potential investment, market forces and other investment considerations. This determination will depend on the nature of the relationship that exists between the dealer and the institutional customer. While the following list is not exhaustive, the MSRB notes that relevant considerations in determining that an institutional customer is making independent investment decisions could include:

- Any written or oral understanding that exists between the dealer and the institutional customer regarding the nature of the relationship between the dealer and the institutional customer and the services to be rendered by the dealer;
- The presence or absence of a pattern of acceptance of the dealer's recommendations;
- The use by the institutional customer of ideas, suggestions, market views and information relating to municipal securities obtained from sources other than the dealer; and
- The extent to which the dealer has received from the institutional customer current comprehensive portfolio information in connection with discussing potential municipal securities transactions or has not been provided important information regarding the institutional customer's portfolio or investment objectives.

Dealers are reminded that these factors are merely guidelines which will be utilized to determine whether a dealer has fulfilled its fair practice obligations with respect to a specific institutional customer transaction and that the inclusion or absence of any of these factors is not dispositive of the determination. Such a determination can only be made on a case-by-case basis taking into consideration all the facts and circumstances of a particular dealer/customer relationship, assessed in the context of a particular transaction. As a means of ensuring that customers continue to meet the defined SMMP criteria, dealers are required to put into place a process for periodic review of a customer's SMMP status.

Application of SMMP Concept to Rule G–17's Affirmative Disclosure Obligations

The SMMP concept as it applies to Rule G–17 recognizes that the actions of a dealer in complying with its affirmative disclosure obligations under Rule G–17 when effecting non-recommended secondary market transactions may depend on the nature of the customer. While it is difficult to define in advance the scope of a dealer's affirmative disclosure obligations to a particular institutional customer, the MSRB has identified the factors that define an SMMP as factors that may be relevant when considering compliance with the affirmative disclosure aspects of Rule G–17.

When the dealer has reasonable grounds for concluding that the institutional customer is an SMMP, the institutional customer, by definition, is already aware, or capable of making itself aware of, material facts and is able to independently understand the significance of the material facts available from established industry sources.[7] When the dealer has reasonable grounds for concluding that the customer is an SMMP then the dealer's obligation when effecting non-recommended secondary market transactions to ensure disclosure of material information available from established industry sources is fulfilled. There may be times when an SMMP is not satisfied that the information available from established industry sources is sufficient to allow it to make an informed investment decision. In those circumstances, the MSRB believes that an SMMP can recognize that risk and take appropriate action, be it declining to transact, undertaking additional investigation or asking the dealer to undertake additional investigation.

This interpretation does nothing to alter a dealer's duty not to engage in deceptive, dishonest, or unfair practices under Rule G–17 or under the federal securities laws. In essence, a dealer's disclosure obligations to SMMPs when effecting non-recommended secondary market transactions would be on par with inter-dealer disclosure obligations. This interpretation will be particularly relevant to dealers operating electronic trading platforms, although it will also apply to dealers who act as order takers over the phone or in-person.[8] This interpretation recognizes that there is no need for a dealer in a non-recommended secondary market transaction to disclose material facts available from established industry sources to an SMMP customer that already has access to the established industry sources.[9]

As in the case of an inter-dealer transaction, in a transaction with an SMMP, a dealer's intentional withholding of a material fact about a security, where the information is not accessible through established industry sources, may constitute an unfair practice violative of Rule G–17. In addition, a dealer may not knowingly misdescribe securities to the customer. A dealer's duty not to mislead its customers is absolute and is not dependent upon the nature of the customer.

Application of SMMP Concept to Rule G–18 Interpretation—Duty To Ensure That Agency Transactions Are Effected at Fair and Reasonable Prices

Rule G–18 requires that each dealer, when executing a transaction in municipal securities for or on behalf of

[7] The MSRB has filed a related notice regarding the disclosure of material facts under Rule G–17 concurrently with this filing. *See* File No. SR–MSRB–2002–01. The MSRB's Rule G–17 notice provides that a dealer would be responsible for disclosing to a customer any material fact concerning a municipal security transaction (regardless of whether such transaction had been recommended by the dealer) made publicly available through sources such as the NRMSIR system, the MSIL® system, TRS, rating agency reports and other sources of information relating to the municipal securities transaction generally used by dealers that effect transactions in municipal securities (collectively, ''established industry sources'').

[8] For example, if an SMMP reviewed an offering of municipal securities on an electronic platform that limited transaction capabilities to broker-dealers and then called up a dealer and asked the dealer to place a bid on such offering at a particular price, the interpretation would apply because the dealer would be acting merely as an order taker effecting a non-recommended secondary market transaction for the SMMP.

[9] In order to meet the definition of an SMMP an institutional customer must, at least, have access to established industry sources.

a customer as agent, make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions.[10] The actions that must be taken by a dealer to make reasonable efforts to ensure that its non-recommended secondary market agency transactions with customers are effected at fair and reasonable prices may be influenced by the nature of the customer as well as by the services explicitly offered by the dealer.

If a dealer effects non-recommended secondary market agency transactions for SMMPs and its services have been explicitly limited to providing anonymity, communication, order matching and/or clearance functions and the dealer does not exercise discretion as to how or when a transaction is executed, then the MSRB believes the dealer is not required to take further actions on individual transactions to ensure that its agency transactions are effected at fair and reasonable prices.[11] By making the determination that the customer is an SMMP, the dealer necessarily concludes that the customer has met the requisite high thresholds regarding timely access to information, capability of evaluating risks and market values, and undertaking of independent investment decisions that would help ensure the institutional customer's ability to evaluate whether a transaction's price is fair and reasonable.

This interpretation will be particularly relevant to dealers operating alternative trading systems in which participation is limited to dealers and SMMPs. It clarifies that in such systems, Rule G–18 does not impose an obligation upon the dealer operating such a system to investigate each individual transaction price to determine its relationship to the market. The MSRB recognizes that dealers operating such systems may be merely aggregating the buy and sell interest of other dealers or SMMPs. This function may provide efficiencies to the market. Requiring the system operator to evaluate each transaction effected on its system may reduce or eliminate the desired efficiencies. Even though this interpretation eliminates a duty to evaluate each transaction, a dealer operating such system, under the general duty set forth in Rule G–18, must act to investigate any alleged pricing irregularities on its system brought to its attention. Accordingly, a dealer may be subject to Rule G–18 violations if it fails to take actions to address system or participant pricing abuses.

If a dealer effects agency transactions for customers who are not SMMPs, or has held itself out to do more than provide anonymity, communication, matching and/or clearance services, or performs such services with discretion as to how and when the transaction is executed, it will be required to establish that it exercised reasonable efforts to ensure that its agency transactions with customers are effected at fair and reasonable prices.

Application of SMMP Concept to Rule G–19 Interpretation—Suitability of Recommendations and Transactions

The MSRB's suitability rule is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct. Dealers' responsibilities include having a reasonable basis for recommending a particular security or strategy, as well as having reasonable grounds for believing the recommendation is suitable for the customer to whom it is made. Dealers are expected to meet the same high standards of competence, professionalism, and good faith regardless of the financial circumstances of the customer. Rule G–19, on suitability of recommendations and transactions, requires that, in recommending to a customer any municipal security transaction, a dealer shall have reasonable grounds for believing that the recommendation is suitable for the customer based upon information available from the issuer of the security or otherwise and based upon the facts disclosed by the customer or otherwise known about the customer.

This guidance concerns only the manner in which a dealer determines that a recommendation is suitable for a particular institutional customer. The manner in which a dealer fulfills this suitability obligation will vary depending on the nature of the customer and the specific transaction. Accordingly, this interpretation deals only with guidance regarding how a dealer will fulfill such ''customer-specific suitability obligations'' under Rule G–19. This interpretation does not address the obligation related to suitability that requires that a dealer have a ''reasonable basis'' to believe that the recommendation could be suitable for at least some customers. In the case of a recommended transaction, a dealer may, depending upon the facts and circumstances, be obligated to undertake a more comprehensive review or investigation in order to meet its obligation under Rule G–19 to have a ''reasonable basis'' to believe that the recommendation could be suitable for at least some customers.[12]

The manner in which a dealer fulfills its ''customer-specific suitability obligations'' will vary depending on the nature of the customer and the specific transaction. While it is difficult to define in advance the scope of a dealer's suitability obligation with respect to a specific institutional customer transaction recommended by a dealer, the MSRB has identified the factors that define an SMMP as factors that may be relevant when considering compliance with Rule G–19. Where the dealer has reasonable grounds for concluding that an institutional customer is an SMMP, then a dealer's obligation to determine that a recommendation is suitable for that particular customer is fulfilled.

This interpretation does not address the facts and circumstances that go into determining whether an electronic communication does or does not constitute a customer-specific ''recommendation.''

Application of SMMP Concept to Rule G–13, on Quotations

New electronic trading systems provide a variety of avenues for disseminating quotations among both dealers and customers. In general, except as described below, any quotation disseminated by a dealer is

[10] This guidance only applies to the actions necessary for a dealer to ensure that its agency transactions are effected at fair and reasonable prices. If a dealer engages in principal transactions with an SMMP, Rule G–30(a) applies and the dealer is responsible for a transaction-by-transaction review to ensure that it is charging a fair and reasonable price. In addition, Rule G–30(b) applies to the commission or service charges that a dealer operating an electronic trading system may charge to effect the agency transactions that take place on its system.

[11] Similarly, the MSRB believes the same limited agency functions can be undertaken by a broker's broker toward other dealers. For example, if a broker's broker effects agency transactions for other dealers and its services have been explicitly limited to providing anonymity, communication, order matching and/or clearance functions and the dealer does not exercise discretion as to how or when a transaction is executed, then the MSRB believes the broker's broker is not required to take further actions on individual transactions to ensure that its agency transactions with other dealers are effected at fair and reasonable prices.

[12] *See e.g.,* Rule G–19 Interpretation—Notice Concerning the Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer's Advertisement, May 7, 1985, *MSRB Rule Book* (July 1, 2001) at 135; *In re F.J. Kaufman and Company of Virginia,* 50 S.E.C. 164, 168, 1989 SEC LEXIS 2376, *10 (1989). The Commission', in its discussion of municipal underwriters' responsibilities, also noted that ''a broker-dealer recommending securities to investors implies by its recommendation that it has an adequate basis for the recommendation.'' *Municipal Securities Disclosure,* Exchange Act Release No. 26100 (September 22, 1988) (the ''1988 SEC Release'') at text accompanying note 72.

presumed to be a quotation made by such dealer. In addition, any ''quotation'' of a non-dealer (*e.g.,* an investor) relating to municipal securities that is disseminated by a dealer is presumed, except as described below, to be a quotation made by such dealer.[13] The dealer is affirmatively responsible in either case for ensuring compliance with the bona fide and fair market value requirements with respect to such quotation.

However, if a dealer disseminates a quotation that is actually made by another dealer and the quotation is labeled as such, then the quotation is presumed to be a quotation made by such other dealer and not by the disseminating dealer. Furthermore, if an SMMP makes a ''quotation'' and it is labeled as such, then it is presumed not to be a quotation made by the disseminating dealer; rather, the dealer is held to the same standard as if it were disseminating a quotation made by another dealer.[14] In either case, the disseminating dealer's responsibility with respect to such quotation is reduced. Under these circumstances, the disseminating dealer must have no reason to believe that either: (i) the quotation does not represent a bona fide bid for, or offer of, municipal securities by the maker of the quotation or (ii) the price stated in the quotation is not based on the best judgment of the maker of the quotation of the fair market value of the securities.

While Rule G–13 does not impose an affirmative duty on the dealer disseminating quotations made by other dealers or SMMPs to investigate or determine the market value or bona fide nature of each such quotation, it does require that the disseminating dealer take into account any information it receives regarding the nature of the quotations it disseminates. Based on this information, such a dealer must have no reason to believe that these quotations fail to meet either the bona fide or the fair market value requirement and it must take action to address such problems brought to its attention. Reasons for believing there are problems could include, among other things, (i) complaints received from dealers and investors seeking to execute against such quotations, (ii) a pattern of a dealer or SMMP failing to update, confirm or withdraw its outstanding quotations so as to raise an inference that such quotations may be stale or invalid, or (iii) a pattern of a dealer or SMMP effecting transactions at prices that depart materially from the price listed in the quotations in a manner that consistently is favorable to the party making the quotation.[15]

In a prior MSRB interpretation stating that stale or invalid quotations published in a daily or other listing must be withdrawn or updated in the next publication, the MSRB did not consider the situation where quotations are disseminated electronically on a continuous basis.[16] In such case, the MSRB believes that the bona fide requirement obligates a dealer to withdraw or update a stale or invalid quotation promptly enough to prevent a quotation from becoming misleading as to the dealer's willingness to buy or sell at the stated price. In addition, although not required under the rule, the MSRB believes that posting the time and date of the most recent update of a quotation can be a positive factor in determining whether the dealer has taken steps to ensure that a quotation it disseminates is not stale or misleading.

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 MSRB 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 MSRB 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 Statutory Basis for, the Proposed Rule Change

The MSRB decided to issue interpretive guidance to address the issues surrounding the development of electronic trading as an outgrowth of a May 2000 MSRB-hosted roundtable discussion about the use of electronic trading systems in the municipal securities market. Industry discussion at the roundtable, as well as subsequent industry comments, made it apparent that the municipal securities market, like the equity market, is in the process of developing alternative models of trading relationships between dealers and customers. In addition, technological innovation is spearheading the development of trading platforms that hope to increase liquidity, transparency and efficiency in the municipal securities market. All of these developments essentially flow from the belief that there is a demand for trading methodologies that allow a dealer to act as an order taker when effecting transactions with customers.

Based on the comments from the industry as well as the MSRB's review of market developments, the MSRB concluded that in order for innovation to occur, the industry needs interpretive guidance on the application of certain MSRB rules to these new trading methodologies. Alternative trading systems present the most graphic example of changing dealer/customer relationships and consequent need for regulatory change, but the changing relationships are not necessarily limited to electronic trading venues.

Ultimately, the MSRB determined that a primary purpose of its interpretive guidance should be to interpret MSRB rules to allow the development of trading relationships where the dealer acts as an order taker in secondary market non-recommended municipal securities transactions with sophisticated institutional investors. The MSRB proposed the SMMP concept to illustrate how different fair practice rules would operate when dealers were transacting with sufficiently sophisticated market professionals. The MSRB did not believe that disclosure and transparency in the municipal securities market are sufficiently developed at this time to permit dealers to have only order taker responsibilities when transacting with retail investors and less sophisticated institutional investors.

The interpretive notice defines an ''institutional customer'' for purposes of the notice and provides that when a dealer has reasonable grounds for concluding that an institutional customer (i) has timely access to the publicly available material facts concerning a municipal securities transaction; (ii) is capable of independently evaluating the investment risk and market value of the

[13] A customer's bid for, offer of, or request for bid or offer is included within the meaning of a ''quotation'' if it is disseminated by a dealer.

[14] The disseminating dealer need not identify by name the maker of the quotation, but only that such quotation was made by another dealer or an SMMP, as appropriate.

[15] The MSRB believes that, consistent with its view previously expressed with respect to ''bait-and-switch'' advertisements, a dealer that includes a price in its quotation that is designed as a mechanism to attract potential customers interested in the quoted security for the primary purpose of drawing such potential customers into a negotiation on that or another security, where the quoting dealer has no intention at the time it makes the quotation of executing a transaction in such security at that price, could be a violation of rule G–17. *See* Rule G–21 Interpretive Letter—Disclosure Obligations, MSRB Interpretation of May 21, 1998, *MSRB Rule Book* (July 1, 2001) at p. 139.

[16] *See* Rule G–13 Interpretation, Notice of Interpretation of Rule G–13 on Published Quotations, April 21, 1988, *MSRB Rule Book* (July 1, 2001) at 91.

municipal securities at issue; and (iii) is making independent decisions about its investments in municipal securities, and other known facts do not contradict such a conclusion, the institutional customer can be considered an SMMP. The guidance also provides that while it is difficult to define in advance the scope of a dealer's fair practice obligations with respect to a particular transaction, as is discussed in the interpretation, by making a reasonable determination that an institutional customer is an SMMP, then certain of the dealer's fair practice obligations (*i.e.,* Rule G–17's affirmative disclosure obligations, Rule G–18's duty to ensure that agency transactions are effected at fair and reasonable prices, and Rule G–19's suitability obligations) remain applicable but are deemed fulfilled.[17] In addition, the fact that a quotation is made by an SMMP would have an impact on how such quotation is treated under Rule G–13.

The MSRB believes the proposed rule change is consistent with Section 15B(b)(2)(C) of the Act, which provides that the Board's rules shall:

> be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade * * * to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.

Additionally, the MSRB believes that the proposed rule change is consistent with the Act in that it will allow for the development and growth of new trading methodologies that may lead to increased pooling of liquidity and market based transparency without diminishing essential customer protections.

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

The MSRB does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act, since it would apply equally to all brokers, dealers and municipal securities dealers.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

On September 28, 2000, the MSRB published a notice seeking comment on draft interpretive guidance on dealer responsibilities in connection with both electronic and traditional municipal securities transactions (the ''2000 Notice'').[18] The 2000 Notice defined a class of customers as ''sophisticated market professionals'' (''SMPs''). The 2000 Notice presented the MSRB's views regarding the responsibilities of dealers under the MSRB's fair practice, quotation, uniform practice and new issue securities rules. In response to the 2000 Notice, the MSRB received 17 comment letters from different segments of the market.[19]

On March 26, 2001, the MSRB published and filed with the Commission for immediate effectiveness a portion of the 2000 Notice consisting of three interpretive notices on electronic primary offering systems, on uniform practice requirements for a specific type of trading system, and on electronic recordkeeping.[20] On July 6, 2001, the MSRB published for comment a revised draft interpretive guidance notice that covered two related concepts (the ''2001 Notice'').[21] The first concept concerned rule G–17 and the disclosure of material facts. The second concerned sophisticated municipal market professionals.[22]

In response to the 2001 Notice, the MSRB received eight comment letters; all eight-comment letters addressed the SMMP guidance.[23] After reviewing the comment letters, the Board approved the SMMP notice, with certain modifications and additions, for filing with the Commission.

Comments on the 2000 Notice

The Need for Guidance

Comments Received. The majority of commentators believe that guidance is needed regarding the applicability of MSRB rules in the context of electronic trading systems.[24] In addition, many

[17] However, for purposes of Rules G–17 and G–18, the SMMP concept only applies when the dealer is effecting non-recommended secondary market transactions for SMMP customers.

[18] ''Notice and Draft Interpretive Guidance on Dealer Responsibilities in Connection with Both Electronic and Traditional Municipal Securities Transactions,'' *MSRB Reports*, Vol. 20, No. 2 (November 2000) at 3, *see also* the ''Clarification to the Draft Interpretive Guidance,'' published on November 17, 2000 at the MSRB's web site (http://206.233.231.2/msrb1/archive/etrading.htm).

[19] Letter from Clayton B. Erickson, V.P. Manager, Municipal Bond Trading and Underwriting, A.G. Edwards & Sons, Inc., to Carolyn Walsh and Ernesto Lanza, dated December 1, 2000 (''A.G. Edwards''); letter from Darrick L. Hills, Chair, Municipal Securities Subcommittee, and Maria J.A. Clark, Associate, Association for Investment Management and Research Advocacy, to Ernesto A. Lanza, dated November 30, 2000 (''AIMR''); letter from Olga Egorova, Vice President, Bear Stearns & Co. Inc., to Carolyn Walsh dated November 28, 2000 (''Bear Stearns''); letter from W. Hardy Callcott, Senior Vice President and General Counsel, Charles Schwab & Co., Inc., to Ernesto A. Lanza, dated November 30, 2000 (''Schwab''); letter from Ida W. Draim, Dickstein, Shapiro, Morin & Oshinksy LLP, to Carolyn Walsh, dated October 25, 2000 (''Dickstein, Shapiro''); letter from Michael J. Hogan, General Counsel, DLJ Inc., to Carolyn Walsh, dated December 3, 2000 (''DLJ''); letter from Richard W. Meister, CEO, eBondTrade, to Ernesto A. Lanza, dated November 30, 2000 (''eBondTrade''); letter from Triet M. Nguyen, Senior Vice President Information Services, eBondUSA.com. Inc., to Carolyn Walsh, dated November 29, 2000 (''eBondUSA''); letter from Michael J. Marx, Vice Chairman, First Southwest Company, to Ernesto A. Lanza, dated November 28, 2000 (''First Southwest''); letter from Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute, to Ernesto A. Lanza, dated November 30, 2000 (''ICI''); letter from Jerry L. Chapman, Managing Director, Morgan Keegan & Company, Inc., to Carolyn Walsh, dated November 16, 2000 (''Morgan Keegan''); letter from Bradley W. Wendt, President and Chief Operating Officer, and David L. Becker, General Counsel, MuniGroup.com LLC, to Carolyn Walsh, dated December 1, 2000 (''MuniGroup''); letter from Dina W. Kennedy, Chairman, National Federation of Municipal Analysts, to Carolyn Walsh, dated November 1, 2000 (''NFMA''); letter from Stuart J. Kaswell, Senior Vice President and General Counsel, Securities Industry Association, to Carolyn Walsh, dated December 4, 2000 (''SIA''); letter from Roger G. Hayes, Chair, The Bond Market Association Municipal Securities Division E-Commerce Task Force, to Ernesto A. Lanza, dated December 1, 2000 (''TBMA''); letter from Lynnette Kelly Hotchkiss, Vice President and Associate General Counsel, The Bond Market Association, to Ernesto A. Lanza, dated January 4, 2001 (''TBMA II''); and letter from William L. Nichols, Chief Operating Officer, ValuBond Securities, Inc., to Carolyn Walsh, dated November 30, 2000 (''ValuBond'').

[20] *See* ''Interpretation on the Application of Rules G–32 and G–36 to New Issue Offerings Through Auction Procedures,'' *MSRB Reports*, Vol. 21, No. 1 (May 2001) at 37; ''Interpretation on the Application of Rules G–8, G–12 and G–14 to Specific Electronic Trading Systems,'' *MSRB Reports*, Vol. 21, No. 1 (May 2001) at 39; and ''Interpretation on the Application of Rules G–8 and G–9 to Electronic Recordkeeping,'' *MSRB Reports*, Vol. 21, No. 1 (May 2001) at 41.

[21] ''Notice and Draft Interpretive Guidance on Rule G–17—Disclosure of Material Facts and Interpretive Guidance Concerning Sophisticated Municipal Market Professionals,'' *MSRB Reports*, Vol. 21, No. 2 (July 2001) at 3.

[22] This filing relates only to the SMMP guidance. Concurrently with this filing, the MSRB is filing with the Commission a notice relating to the Rule G–17 interpretive guidance. *See* Filing No. SR–MSRB–2002–01.

[23] Letter from Linda L. Rittenhouse, Staff, Association for Investment Management and Research Advocacy, to Carolyn Walsh, dated October 19, 2001 (''AIMR II''); letter from David C. Witcomb, Jr., Vice President, Compliance Department, Charles Schwab & Co., Inc., to Carolyn Walsh, dated October 11, 2001 (''Schwab II''); letter from Michael J. Marx, Vice Chairman, First Southwest Company, dated October 12, 2001 (''First Southwest II''); letter from Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute, dated October 19, 2001 (''ICI II''); letter from Alan Polsky, Chairman, National Federation of Municipal Analysts, dated November 13, 2001 (''NFMA II''); letter from Roger G. Hayes, Chair, The Bond Market Association Municipal Securities Division E-Commerce Task Force, dated October 10, 2001 (''TBMA III''); letter from Thomas S. Vales, Chief Executive Officer, TheMuniCenter, dated October 1, 2001 (''MuniCenter''); and letter from David Levy, Sr. Associate General Counsel, First Vice President, UBS Paine Webber Inc., dated October 19, 2001 (''UBSPW'').

[24] *See* A.G. Edwards, AIMR, Bear Stearns, eBondTrade, First Southwest, ICI, MuniGroup, NFMA, Schwab, TBMA, and ValuBond, *supra* note

Continued

commentators commend the MSRB's decision to continue to apply existing rules to the online market.[25]

Application of the SMP Concept to Fair Practice Obligations

Retention of SMP Differentiation

Comments Received. The MSRB received numerous comment letters on the 2000 Notice about the SMP proposal.[26] Those commentators that were opposed to the concept expressed concern that the SMP concept would create two-tiered markets where SMPs and dealers receive prices superior to retail customers and less sophisticated institutions and transactions will be driven to the less regulated market.[27] Seven commentators approved of the MSRB's recognition that certain municipal securities market participants have substantially greater sophistication than others.[28] Those that were in favor of the concept in general remain concerned that as drafted the SMP concept is too difficult to implement in practice. Three commentators called for the MSRB to identify classes of investors who are ''otherwise qualified'' market professionals (*e.g.,* Qualified Purchasers as defined under the Investment Company Act, Qualified Institutional Buyers as defined under Securities Act Rule 144A, etc.) who will be presumed to be SMPs, or allow dealers to rely upon written representations from institutional investors that they are SMPs.[29] On the other hand, certain institutional investors believe that the SMP criteria, as written, give broker-dealers too much flexibility to determine who is an SMP.[30]

MSRB Response. The MSRB determined to retain the SMP proposal with the revisions in the 2001 Notice.[31] The MSRB believes that certain customers (SMMPs) are sufficiently familiar with the market to participate on a par with dealers when engaging in non-recommended secondary market transactions. In addition, SMMPs are sufficiently sophisticated about financial matters and versed in the municipal securities at issue so that they are not in need of a dealer's customer-specific suitability analysis when a dealer recommends certain municipal securities. They thus should be able to access the market, either through automated systems or otherwise, without the same level of dealer responsibility now required for less sophisticated customers. Such market access should be at a lower cost than the dealer's current ''full service.'' There is support in law and regulatory precedent for differentiating between types of investors.[32] However, the MSRB did not allow classes of ''otherwise qualified'' market professionals to be presumed to be SMPs and did add a $100 million asset requirement to ensure that only the most sophisticated municipal market professionals would come within the definition of SMMP.

Application of SMP Criteria [33]

Rule G–17: Conduct of Municipal Securities Activities

Comments Received.

a. Disclosure. Several commentators expressed the opinion that SMPs need a dealer to provide G–17 affirmative disclosure information to them about municipal securities transactions.[34] For example, ICI stated:

Furthermore, not all information that is disclosed by an issuer is necessarily filed with or collected by Information Repositories, and such public information as may be available from the Information Repositories may be too sparse or outdated to provide, on its own, an adequate basis for an investor to make an informed credit decision * * *. In those situations, the dealer selling municipal securities may possess, or be in the best position to acquire, public information that is relevant and material to the investor. Due to the fragmented nature of currently ''available'' information about municipal securities, it cannot be presumed that an investor, however sophisticated, has access to all information that has been gathered by or is available to a dealer, and the duty of a dealer to disclose all such material information remains an important and necessary protection for all investors.[35]

In contrast to such comments, TBMA in its supplemental letter stated:

We believe that it is illogical and without merit to link the quality and adequacy of disclosure with the designation of an investor class as SMPs

19. For example, AIMR ''applauds the timeliness of the MSRB's proposal. We all recognize that electronic trading platforms are the way of the future and, as such, the industry should begin assessing the feasibility of and potential conflicts that may arise from their use.''

[25] *See e.g.,* A.G. Edwards, Bear Stearns, eBondTrade, First Southwest, ICI, Schwab and TBMA, *supra* note 19. For example, ''Schwab welcomes the MSRB's recognition, parallel to that of all other major US securities regulators, that the online channel of customer access should be subject to the same basic regulatory scheme as traditional means of customer access.''

[26] Ten comment letters directly addressed the SMP concept. *See* A.G. Edwards, AIMR, Bear Stearns, eBondTrade, First Southwest, ICI, NFMA, Schwab, TBMA, and ValuBond, *supra* note 19.

[27] *See* ICI, NFMA, and Schwab, *supra* note 19. For example, Schwab stated that:

A consistent disclosure standard for retail and institutional investors would permit firms to build ECN-like trading platforms that allow for participation of all investors, retail and institutional. Such fully integrated trading systems could contribute to improved liquidity, better pricing and fairness for retail investors by avoiding two-tiered markets where institutions and dealers receive superior prices. We urge the MSRB to avoid creating regulatory incentives, which would lock retail investors out of the most cost-efficient and up-to-date online bond trading systems.

[28] *See* A.G. Edwards, AIMR, Bear Stearns, eBondTrade, First Southwest, TBMA, and ValuBond, *supra* note 19. TBMA stated that:

We strongly support the Board's identification of ''sophisticated market professionals.'' The proposed definition of a subset of investors who are ''sophisticated market professionals,'' for whom a firm's customer-specific suitability obligations are presumed met, will promote the development of the online municipal market. Initially, trading platforms will be able to simplify their regulatory obligations, cut costs, and improve their ability to compete by limiting access to sophisticated investors. These limited access platforms will be able to serve as laboratories for technological innovation, and sophisticated investors will benefit from the availability of platforms tailored to their special needs. Ultimately, however, trading methods and technologies developed through these platforms may be extended to retail investors as well, thereby benefiting all investors and improving liquidity throughout the municipal market.

[29] *See* A.G. Edwards, First Southwest, and TBMA, *supra* note 19.

[30] *See* AIMR, *supra* note 19 (''we agree in general with the basic premise in establishing the sophisticated investor criteria. [However,] as written we believe that the criteria give broker/dealers too much flexibility to determine who is and who is not a sophisticated client.'').

[31] *See infra* notes 70–71 and accompanying text for a discussion of the MSRB's Response to Comments regarding the retention of the SMMP differentiation in the 2001 Draft Guidance.

[32] For example, the NASD recognized this concept in its approach to determining the scope of a member's suitability obligation in making recommendations to an institutional customer. (''[A] broker/dealer frequently has knowledge about the investment and its risks and costs that are not possessed by or easily available to the investor. Some sophisticated institutional customers, however, may in fact possess both the capability to understand how a particular securities investment could perform, as well as the desire to make their own investment decisions without reliance on the knowledge or resources of the broker/dealer.'') *NASD Notice to Members 96–66, ''Suitability Obligations to Institutional Investors''* (October 1996).

[33] All of the commentators' written concerns with the SMP concept related to dealers' rule G–17 obligations. No specific written comments were made in regard to the application of the SMP concept to a dealer's rules G–18 and G–19 obligations.

[34] *See e.g.,* AIMR; ICI; and NFMA, *supra* note 19.

[35] *See* ICI, *supra* note 19. Similarly, NFMA stated that the ''Draft Interpretive Guidance overestimates the information available to investors of any ilk in the municipal securities market, and underestimates the role of the dealer as a centralized purveyor of available information about particular securities.'' *Id.* The MSRB has addressed some investor concerns and clarified certain misunderstandings relating to dealers' Rule G–17 affirmative disclosure obligations in its Rule G–17 interpretive notice filed concurrently herewith. *See* File No. SR–MSRB–2002–01.

* * *. [T]he Interpretive Release is not diluting or reducing the amount or type of disclosure available to SMPs. It merely recognized that for this particular investor class, access to information is readily available to both the SMP and the dealer, and that efficiencies could be achieved through the different application of MSRB rules.[36]

b. Rule G–17 Safe Harbor. Several commentators urged the MSRB to afford dealers a safe harbor or other guidance under rule G–17. [37] For example, eBondTrade urged the MSRB ''to afford the dealer a safe harbor under Rule G–17 for hyperlinks on the dealers' platforms to other parties such as issuer websites, rating agencies, and other pertinent information sources * * *. [eBondTrade] also recommend[s] that a similar safe harbor be afforded for dealers using indicative data sources provided by such firms as J. J. Kenny, Interactive Data (Muller) and Bloomberg data to create municipal bond descriptions.'' [38]

Similarly, while Schwab did not suggest a safe harbor *per se*, it urged the MSRB ''to resist the temptation of holding online firms to a higher standard than traditional delivery channels.'' Schwab went on to note that ''most current online disclosure practices are more than adequate,'' and that ''[f]or online bond trading systems, several reputable vendors provide descriptive information about bond issues which meets the Rule G–17 disclosure standards.'' [39] However, DLJ stated:

If ATSs are exempt from several MSRB rules when linking with dealers or sophisticated market professionals, MSRB interpretations appear to assume that the dealers, including online brokers, may need to comply with these requirements * * *. For example, the interpretation for MSRB's Rule G–17 suggests that ATSs would not be responsible for providing descriptive information to customers. It would be difficult if not impossible for an online firm, displaying to its customers all products listed on the ATS, to ensure that each customer receives all material information at the time the customer is ready to execute a transaction electronically.[40]

MuniGroup, however, asked the MSRB to clarify that in the context of an ATS type-trading platform like MuniGroup, ''the underlying responsibility to the customer lies with the broker-dealer with whom the customer maintains his or her account, and not with the electronic trading platform over which the transaction actually occurs.'' [41]

MSRB Response. In the 2000 Notice, the MSRB stated that the actions of a dealer in complying with its affirmative disclosure obligations under rule G–17 may depend on the nature of the customer. In revising the 2001 Notice, the MSRB retained this concept but clarified that the concept only applies when a dealer is effecting non-recommended secondary market transactions for a customer.

The MSRB also clarified in the 2001 Notice that investors have misunderstood the import of the 2000 Notice by suggesting that it would allow a dealer who had actual knowledge of a material fact that was not accessible to the market to transact with an SMMP without disclosing the information. The 2001 Notice does nothing to alter a dealer's duty not to engage in deceptive, dishonest, or unfair practices under Rule G–17 or under the federal securities laws. Thus, if material information is not accessible to the market but known to the dealer and not disclosed, the dealer may be found to have engaged in an unfair practice. In essence, a dealer's disclosure obligations to SMMPs would be on par with inter-dealer disclosure obligations. There would be no specific requirement for a dealer to disclose all material public facts to a customer that is presumed to know the characteristics of the securities. As in the case of an inter-dealer transaction, in a transaction with an SMMP an intentional failure to disclose an unusual feature of a security not accessible to the market (but known by the dealer) may constitute an unfair practice violative of Rule G–17. In addition, a dealer may not knowingly misdescribe securities to the customer. A dealer's duty not to mislead its customers is absolute and is not dependent upon the nature of the customer.

As noted in the 2001 Notice, the flow of municipal securities disclosure should not be diminished. The SMMP proposal only will relieve a dealer when effecting non-recommended secondary market transactions of its affirmative disclosure obligation to inform the SMMP customer about the information available from established industry sources where the customer is already aware of, or capable of making itself aware, and can independently understand the significance of the material facts available from established industry sources. There may be times when an SMMP is not satisfied that the information available from established industry sources is sufficient to allow it to make an informed investment decision. However, in those circumstances, the MSRB believes that an SMMP can recognize that risk and take appropriate action, be it declining to transact, undertaking additional investigation, or asking the dealer to acquire additional information. Continuing to impose Rule G–17's affirmative disclosure obligations on dealers transacting with SMMPs will not provide the desired additional information. Dealers may not be aware of new or developing material events because issuers have failed to publicly disclose them, or they are not available from established industry sources.

The MSRB believes that this interpretation is consistent with Rule G–17's goal of ensuring that dealers treat customers fairly. It affords dealers flexibility to negotiate understandings and terms with a particular customer when effecting non-recommended secondary market transactions. This approach assists dealers and customers in defining their own expectations and roles with respect to their specific relationship.

The MSRB does not believe that it should provide online dealers with a safe harbor under Rule G–17 for the particular information necessary to fulfill affirmative disclosure obligations when effecting electronic transactions for non-SMMP customers (*e.g.,* hyperlinks to certain indicative data services). Dealers are responsible for disclosing material information to customers. If hyperlinks are not working correctly or indicative data sources have erroneous information, dealers should be liable for the resulting failure to disclose. The MSRB has, however, addressed some commentators concerns about the scope of a dealer's Rule G–17 disclosure obligations in the related Rule G–17 Interpretive Guidance.

[36] TBMA II, *supra* note 19. TBMA further notes that the MSRB's Draft Guidance ''recognizes that premature regulation in an evolving technology will not serve the common goals of the industry.''

[37] *See* eBondTrade, TBMA and ValuBond, *supra* note 19. ValuBond states that the Board should ''articulate standards for a 'safe harbor' for electronic systems which display data about bonds according to descriptive elements (*e.g.,* by rating, type, issuer), and the extent to which such functionality does or does not constitute rendering of financial advice.'' TBMA suggests a G–17 hyperlink safe harbor, stating that although it ''realizes that the subject of liability for hyperlinks is unsettled, we believe that such a safe harbor is consistent with other regulators' treatment of hyperlinks to date.''

[38] eBondTrade, *supra* note 19.

[39] Schwab, *supra* note 19. *See also* eBondUSA, *supra* note 19 (''we would argue that a well–designed market price discovery tool, linked to the appropriate secondary market disclosure sites, will go far toward fulfilling a dealer's 'fair dealing' obligations'').

[40] DLJ, *supra* note 19.

[41] Munigroup, *supra* note 19.

Rule G–18: Execution of Transactions

Comments Received. Only two commentators addressed the MSRB's 2000 guidance concerning Rule G–18. MuniGroup stated that it agrees with the guidance that G–18 does not require a dealer operating a platform to review each transaction to ensure that the prices for the transaction are fair and reasonable. MuniGroup also noted, ''because of the relatively illiquid nature of the municipal market, there is no way for a platform [serving only registered broker-dealers] to ensure that transactions are effected at fair and reasonable prices.'' Similarly, TBMA commented, ''we believe that Rule G–18 does not necessarily require a dealer to check all posted prices on all accessible web sites to ensure a fair and reasonable price for any given municipal securities transaction.'' [42]

MSRB Response. Rule G–18 requires that each dealer, when executing a transaction in municipal securities for or on behalf of a customer as agent, make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions. The 2000 Notice provided that the actions that must be taken by a dealer when effecting agency transactions to make reasonable efforts to ensure that its agency transactions with customers are effected at fair and reasonable prices may be influenced by the nature of the customer as well as by the services explicitly offered by the dealer. In the 2001 Notice, the MSRB made changes to more precisely describe the parameters of the services offered by a dealer if the dealer wishes to avail itself of this interpretation.

Rule G–19: Suitability of Recommendations and Transactions

Comments Received. Many commentators expressed concerns about the MSRB's discussion of implicit recommendations and the possibility that a retail customer may view a sending of an inventory list as the equivalent of a recommendation, which would require the dealer to perform a suitability review before selling the security to the retail customer.[43] For example, the SIA argued that inventory lists are not recommendations and that the 2000 Notice ''represents an expansion of the generally accepted definition of recommendation in the context of the suitability rules * * * Regulators have consistently recognized that the distribution of general, impersonal advertising material does not, in itself, give rise to suitability obligations.'' [44]

A few commentators suggested that the MSRB should conform its recommendation and suitability guidance to the NASD's.[45] These commentators generally take the position that the determination of whether a recommendation has been made or not should focus on whether the ''communication is individualized for that particular customer.'' [46] While these commentators state that brokerages have the general obligation to ensure that they have a reasonable basis for information about the securities available on their websites, citing NASD rules, they argue that generalized recommendations do not trigger an individualized suitability obligation whenever an investor reads or acts on that generalized recommendation.

In addition, the SIA argued that if the MSRB guidance that states that the sophistication of the investor and the nature of the relationship with the firm are relevant factors in determining whether a recommendation has been made was meant to emphasize ''those factors at the expense of the content of the communication, then the MSRB guidance will be expanding the definition of suitability.'' [47]

Some commentators suggested that the MSRB issue guidance that affords dealers permission to rely upon an online customer's electronic representations in determining that an investment is suitable for that customer.[48] Several commentators requested further clarification about whether using filters and allowing customers to employ customer controlled search functions constitutes a recommendation.[49] However, A.G. Edwards cautioned the MSRB to ''resist at this time the temptation to adopt specific rules or interpretations that might ultimately dictate what communications give rise, or do not give rise, to suitability obligations.'' [50]

MSRB Response. In publishing the 2000 Notice and the November Clarification, the MSRB intended to be consistent with existing customer suitability analysis by recognizing that historically the determination of whether a dealer is making a recommendation has been made by reference to all relevant facts and circumstances. However, several commentators noted a need for industry consensus on the definition of an online recommendation. A few commentators specifically stated that the MSRB should conform its recommendation and suitability guidance to the NASD's then soon to be released notice on its suitability rule and online communications.[51] In revising the 2001 Notice for comment, the MSRB determined to remove any discussion concerning the identification of when a dealer makes a recommendation online from the SMMP guidance. The MSRB is reviewing the NASD's release and plans to provide additional guidance in this area.

Draft Interpretive Guidance for Quotation Rule

Comments Received. Three commentators provided substantive comment on the MSRB's discussion relating to quotations.[52]

MuniGroup agreed with the basic concept that a dealer disseminating a quotation made by another dealer has a reduced obligation for ensuring compliance with the bona fide and fair market value requirements. However, it stated that many electronic trading systems are anonymous systems that disseminate quotes of various dealers on an undisclosed basis. MuniGroup believes that the MSRB's requirement that a disseminating dealer label a quotation made by another dealer as such ''place[s] the burden of ensuring compliance with the bona fide and fair market value requirements on the dealer operating the electronic trading

[42] *See* MuniGroup and TBMA, *supra* note 19.

[43] *E.g.*, A.G. Edwards; Bear Stearns; DLJ; Schwab; SIA; and TBMA, *supra* note 19. DLJ also argues that the MSRB's assumption that retail customers are unlikely to initiate a transaction on their own ''is not consistent with our business model or our experience, and we think it is an incorrect assumption in this day and age.'' None of the commentators took issue with the MSRB's interpretation exempting dealers from a suitability obligation when transacting with SMPs.

[44] SIA, *supra* note 19. The SIA supported this position by arguing that customers are adequately protected by existing rules, citing a variety of NASD rules on advertising and customer communications.

[45] *E.g.*, DLJ; Schwab; and SIA, *supra* note 19.

[46] SIA, *supra* note 19.

[47] *Id.*

[48] *E.g.*, First Southwest and TBMA, supra note 19. *See also* Morgan Keegan, *supra* note 19 (''How can a dealer operating an electronic trading system possibly know customer specifics other than those given over the computer, and that would probably not hold up under review or arbitration?'') and DLJ (''technology is currently not available for online firms to fulfill suitability obligations electronically'').

[49] *E.g.*, Bear Stearns; TBMA; DLJ; Schwab; and SIA, supra note 19.

[50] A.G. Edwards, *supra* note 19.

[51] The NASD released its Online Suitability Guidance on March 20, 2001. *See NASD Notice to Members 01–23, Online Suitability—Suitability Rule and Online Communications* (April 2001).

[52] MuniGroup, Schwab and AIMR, *supra* note 19. In addition, First Southwest stated that rule G–13 should ''address the assessment responsibility of the electronic trading platforms through which online transactions take place,'' an apparent reference to Rule A–13's assessments on inter-dealer and customer transactions. First Southwest, *supra* note 19.

system.'' It argued that, since participants in such an anonymous system are aware that the dealer operating the system is not actually making quotations, ''the position of the MSRB should be clarified to make clear that the dealer operating the electronic trading system is not the dealer responsible for ensuring compliance with the bona fide and fair market value requirements.'' [53]

Schwab stated that it is troubled that a dealer has a higher compliance obligation when disseminating a quote made by a retail customer (which the disseminating dealer must treat as its own quotation) than when disseminating a quote made by a sophisticated market professional (which the disseminating dealer may treat as if made by another dealer if the quote is labeled as having been made by a sophisticated market professional). It argued, ''[t]here is no reason to believe that retail investors are more likely than institutions to enter quotes that are not bona fide or are unfairly priced.'' [54] Schwab noted that Rule G–13, as interpreted by the MSRB, ''would allow institutions and dealers to quickly and efficiently enter bids and offers in ECNs. For retail orders, however, the dealer sponsoring the system would have to review and approve the bids and offers before they could be entered into the system.'' Schwab stated that the pace of online trading might not allow the dealer sufficient time to assess the fair market value of the securities quoted and, if there is no direct relationship between the dealer and the customer, the dealer may not be able to assess whether the quote is bona fide. It suggested that all customer quotes be treated in the manner proposed by the MSRB for sophisticated market professionals.

AIMR suggested that dealers be required to post the time of the most recent change in price posted on a trading platform, which ''would automatically alert potential investors to the possible staleness of a quote.'' [55]

MSRB Response. The 2000 Notice recognized that new electronic trading systems provide a variety of avenues for disseminating quotations among both dealers and customers. The MSRB, in fact, intended that the disseminating dealer only be required to note that the quotation that it was disseminating had been made by another dealer, not that it be required to reveal the actual identity of the dealer making the quotation. The 2001 Notice clarified this point. The 2001 Notice also stated that although not required by the rule, the MSRB believes that posting the time and date of the most recent update of a quotation can be a positive factor in determining whether the dealer has taken steps to ensure that a quotation it disseminates is not stale or misleading.

The MSRB did not however, adopt Schwab's suggestion that disseminating dealers be allowed to treat quotes made by retail customers as quotes made by another dealer. The MSRB believes that the structure of the municipal securities market along with the informational disadvantages retail customers have make it reasonable to assume that retail investors are more likely to enter quotes that do not reasonably relate to the fair market value of the securities. Therefore, it is necessary to require dealers who operate systems to review and approve the quotes as bona fide before they can be disseminated by the system.

Comments on the 2001 Notice

Sophisticated Municipal Market Professional—Definition

$100 Million Threshold

Comments Received. Three commentators on the 2001 Notice expressed the opinion that the threshold requirement that an SMMP own or control $100 million in municipal securities ''is unnecessarily high, and may deny access to online trading systems to a number of very large institutions with significant municipal holdings that are otherwise capable of participating in these systems.'' [56] All three commentators suggested changing the threshold to $50 million and noted that this threshold would be consistent with the Board's own definition of ''institutional account'' in Rule G–8(a)(xi), and with the NASD's institutional suitability guidelines. TBMA also stated that a $50 million threshold would benefit the markets by providing access to a number of very large institutional investors that are not SMMPs under the proposed standard. Specifically, TBMA stated that reducing the threshold to $50 million would increase the percentage of qualified institutions to 43%, up from less than 29% when the threshold is $100 million.[57]

MSRB Response. The MSRB determined to add the $100 million threshold to the SMMP definition as a way of ensuring that SMMPs are truly the most sophisticated of institutional investors. According to TBMA's data, lowering the threshold to $50 million will result in close to 50% of all large institutional investors being eligible to be an SMMP. Moreover, the comment letters from First Southwest, MuniCenter and TBMA are directly contrary to the comments from AIMR. AIMR believes the $100 million limit is too low and stated that the $100 million limit can easily be met without the ''concomitant demonstration of being a sophisticated investor.'' [58]

Although the comment letters expressed concern about denying electronic trading access to smaller institutions, the SMMP definition should not operate in that fashion. An institutional investor that does not have the level of assets in the definition of the SMMP will not be foreclosed from trading if the dealer offering the platform is providing sufficient information services, beyond transaction execution.[59] Indeed, there is evidence that many dealers are developing electronic trading systems designed to provide extensive informational services and otherwise fulfill dealers' fair practice obligations.[60] Moreover, while many other ''sophisticated investor'' regulations have lower dollar thresholds, the threshold for qualified institutional buyers (''QIBs'') is also set at $100 million, and the Board believes

[53] MuniGroup, *supra* note 19.

[54] Schwab, *supra* note 19. Schwab appeared to assume, incorrectly, that all institutional investors would be treated as sophisticated market professionals.

[55] AIMR, *supra* note 19. AIMR also suggested that market transparency and liquidity would be improved by requiring public disclosure of trades of $1 million or more on a real-time basis, stating that ''[n]ext day information * * * provides little insight to the current market depth and trading range that would be relevant for a particular trade investors may be considering at that moment.'' In addition, ValuBond asked, ''How the MSRB will view price discrepancies between actual bond quotations and MSRB trade data or market evaluation?'' ValuBond, *supra* note 19.

[56] *See* First Southwest II, MuniCenter, and TBMA III, *supra* note 23. In contrast, AIMR stated that the $100 million dollar threshold is too low and they suggested a two-tiered analysis. An investor could be presumed to be an SMMP if it reached an asset threshold of $1 billion dollars in municipal securities. In the alternative, if the investor has assets of less than $1 billion dollars, but more than $100 million dollars and is able to satisfy additional criteria, it could be treated as an SMMP. *See* AIMR II, *supra* note 23.

[57] *See* TBMA III, *supra* note 23. TBMA's estimates are based on a sample of approximately 1,200 large institutional investors (the top 500 banks, 547 insurance companies, and 150 largest mutual funds). *Id.*

[58] *See* AIMR II, *supra* note 23.

[59] Similarly, dealers that wish to allow their retail customers to view offerings on ATS type platforms may do so. However, the dealers sponsoring retail customers are responsible for providing their customers with Rule G–17 disclosures and for ensuring that the transaction prices are fair and reasonable.

[60] For example, MuniCenter made representations that it ''probably exceeds traditional services offered by dealers.'' MuniCenter, *supra* note 23.

that the purposes behind the QIB threshold are most analogous to the SMMP definition.[61] Therefore, the MSRB has determined to keep the threshold at $100 million.

Presumption of Sophistication

Comments Received. Several commentators suggested that the SMMP definition be altered to allow investors to be presumed sophisticated if they meet the investment threshold.[62] The commentators pointed out that the presumption could be rebutted if the dealer knew or should have known that an investor lacked sophistication concerning a municipal securities transaction as defined in the SMMP guidance. The commentators stated that requiring a dealer to always make individualized judgments that investors meet the definition might hinder dealers' efforts to streamline access to online trading.[63]

MSRB Response. The MSRB believes that there should not be a presumption of SMMP status for those institutions with $100 million or greater in municipal securities. The inclusion of a presumption would make the rest of the SMMP guidance concerning who is, or is not an SMMP meaningless. The MSRB believes that dealers should be required to undertake some level of investigation to determine if a customer meets the SMMP criteria and should not be allowed to presume that an institution is sophisticated just because it meets the $100 million threshold. Indeed, AIMR noted, ''[w]ealth alone (as determined by a specific dollar amount of assets under management or within a portfolio) does not translate into investment knowledge.'' [64]

Requiring Institutional Investors to Attest to SMMP Status

Comments Received. Two commentators, AIMR and UBSPW, also suggested a mechanism for eliminating some of the ambiguity of the ''reasonable grounds'' test for determining if a customer is an SMMP.[65] AIMR urged the MSRB to ''[s]hift the ultimate responsibility from the dealer to the investor to determine and represent that it qualifies as a sophisticated market professional * * *.'' UBSPW suggested that the SMMP proposal would be improved if the MSRB permits ''dealers to rely upon either (1) the representation of a potential user that it has the characteristics the Board has identified as indicative of a sophisticated municipal market professional; or (2) a contract pursuant to which the participant agrees to waive the disclosure, suitability and price 'protections' that would otherwise be afforded that same customer in the context of a recommendation.'' [66]

MSRB Response. The SMMP Interpretive Guidance is designed to help dealers understand their fair practice obligations when effecting secondary market transactions for certain customers. As the fair practice obligations are the dealers', the MSRB believes it would be inappropriate to shift the ultimate responsibility for determining the scope of those obligations entirely to the customer. While the major rationale of AIMR's suggestion that investors be required to attest to SMMP status was an effort to streamline the process by which dealers determine that a customer is an SMMP, they also raised it as a mechanism to prevent customers who do not want to be considered SMMPs from being treated as such. However, an institution can only be treated as an SMMP, for purposes of Rules G–17 and G–18, if the institution has decided that it wants to engage in a non-recommended secondary market transaction. So, to a large extent, the institutions that can be considered SMMPs are self-selecting—they are the self-directed institutional investors that want to transact with a dealer who will act as an order taker.

As the MSRB recognized in the 2001 Notice, the SMMP interpretation ''affords dealers flexibility to negotiate understandings and terms with a particular customer when effecting non-recommended secondary market transactions. This approach assists dealers and customers in defining their own expectations and roles with respect to their specific relationship.'' Therefore, the MSRB determined that the revised interpretive notice should specifically advise dealers that they may choose to have customers attest to SMMP status as a means of streamlining the dealers' process for determining that the customer is an SMMP and ensuring that customers are informed as to the consequences of being treated as an SMMP. Of course, a dealer would not be able to rely upon a customer's SMMP attestation if the dealer knew or should have known that an investor lacked sophistication concerning a municipal securities transaction as defined in the SMMP guidance.

Confirming SMMP Status

Comments Received. TBMA noted that the 2001 Notice is silent as to how often a dealer must confirm that a customer still qualifies as an SMMP. TBMA recommended that dealers be allowed to confirm SMMP status as part of their regular review of new account information.[67]

MSRB Response. The SMMP interpretive guidance has been revised to include a statement that would clarify that dealers are required to put a process in place for periodic review of customer's SMMP status.

Application of SMMP Interpretation to Fair Practice Obligations

Retention of SMMP Differentiation

Comments Received. Two commentators, Schwab and NFMA, again challenged the MSRB's decision to create the SMMP differentiation. Schwab is concerned that the SMMP proposal ''will undoubtedly foster the creation and growth of electronic bond trading systems that cater solely to professional dealers and institutional investors and exclude participation by retail investors..'' [68] The NFMA's concerns are two-fold. First, they ''are troubled by the notion that certain market participants have enough direct access to information as to make redundant a dealers' affirmative disclosure of material facts * * *.'' Therefore, they ''cannot endorse the SMMP concept as a means of promoting electronic trading before a general strengthening of the existing secondary disclosure structure occurs.'' Second, the NFMA ''remains concerned that the concept of the SMMP as currently developed creates two tiers of investors. * * *. The NFMA is concerned that retail investors and smaller institutional investors will not have access to electronic systems.'' [69]

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[61] A QIB is an institution of a type listed in Rule 144A that owns or invests on a discretionary basis at least $100 million of certain securities. *See* 17 CFR 230.144A(a)(1). The QIB definition is used to identify institutions that can purchase offerings that are exempt from the registration provisions of the Securities Act and in which the securities are eligible for resale pursuant to Rule 144A under the Securities Act (''Rule 144A offerings'').

[62] *See* First Southwest II, TBMA III and AIMR II (albeit at a level of $1 billion dollars), *supra* note 23. TBMA also suggested that ''any fund that invests solely in municipal securities should be presumed sophisticated, because such funds in effect hold themselves out to the public as possessing special expertise.''

[63] *See e.g.*, AIMR II (suggesting that while in theory asking the dealer to make a determination that a customer is an SMMP may sound reasonable, in many instances it is not practicable, especially for smaller dealers), *supra* note 23.

[64] AIMR II, *supra* note 23.

[65] *See* AIMR II and UBSPW, *supra* note 23.

[66] *Id.*

[67] TBMA III, *supra* note 23.

[68] *See* NFMA II and Schwab II, *supra* note 23.

[69] NFMA II. *See also* AIMR II (''We continue to have concerns about any efforts to decrease disclosure in the municipal securities market.''), *supra* note 23.

MSRB Response. As noted above,[70] the MSRB believes that there is considerable merit in differentiating between customers with different degrees of sophistication. The MSRB believes that the SMMP guidance, as revised, is narrowly crafted so as to retain necessary customer protections for both retail and SMMP customers.

Moreover, while both Schwab and the NFMA posited that the MSRB guidance would foster the development of electronic trading systems that cater only to dealers and SMMPs, there is no evidentiary support for that statement. Rather, electronic trading systems area continuing to develop for retail and non-SMMP customers and the SMMP proposal was not intended to prohibit participation by retail participants in the electronic marketplace.[71]

Additionally, although Schwab's comment letter urged the MSRB to foster the development of systems that allow retail investors to be able to trade on an equal footing with dealers and institutions, these comments do not take into account the reality of the municipal securities market. While Schwab noted that there is no need to differentiate between SMMPs and non-SMMPs in certain markets such as the Nasdaq market, there are significant differences between the municipal securities market and other markets. Municipal securities are not part of the national market system. It would be very difficult for a retail investor to know whether a municipal security is being offered at a price that is fair and reasonable. There is, for example, no consolidated tape reporting contemporaneous quotes and transaction prices. Only rarely is a specific municipal security traded with sufficient frequency to allow a less sophisticated investor to obtain transaction information to assist in an analysis of the price being offered. Moreover, there is no mandated issuer disclosure, and very little publicly available and free disclosure information. It is very likely that retail and less sophisticated institutional investors would not even know where to go to independently assess the accuracy or timeliness of information about a municipal security. Given these circumstances, the MSRB believes that most retail and less sophisticated institutional customers at this time continue to need dealers to be specifically obligated to fulfill their fair practice obligations by, *inter alia,* affirmatively disclosing any material fact concerning a municipal security transaction made publicly available through established industry sources and taking reasonable steps to ensure that agency transactions are effected at fair and reasonable prices.

Application of Board Rules to Both Traditional and Electronic Trading Systems

Comments Received. The ICI suggested that the SMMP concept should be limited to electronic trading platforms. The ICI stated, ''[w]hile we agree with the MSRB's position that it is appropriate to relieve dealers operating electronic trading platforms of their affirmative disclosure obligations under rule G–17 for the limited purpose of executing non-recommended secondary market transactions, we do not believe that dealers should be relieved of their disclosure obligations when effecting transactions of such securities generally. There has been no demonstrated need to expand the SMMP concept to non-electronic trading, which to date has successfully operated without it.'' [72]

MSRB Response. The MSRB does not believe that electronic transactions should be subject to different regulation than transactions that take place over the phone or in person. The dealers' obligations should be the same no matter what the medium of communication. While the SMMP interpretation will be particularly relevant to dealers operating electronic trading platforms, it could also apply to dealers who act as order takers in over the phone or in-person transactions.[73]

While the ICI objected to applying the SMMP concept to non-electronic transactions, the ICI has not identified a danger from applying the SMMP concept to telephonic or in-person transactions where the dealer is acting as an order taker and effecting a non-recommended secondary market transaction for an SMMP. Moreover, the MSRB's determination to apply the SMMP concept to both electronic and non-electronic trading is consistent with the efforts of the Commission and other self-regulatory organizations to ensure that the regulatory requirements for dealers to undertake specific investor protection responsibilities should not depend on whether a transaction takes place electronically, over the telephone, or face-to-face. Several commentators commended the MSRB for this approach.[74]

The SMMP Concept Should Not Apply to Securities Exempt UnderRule 15c2–12

Comments Received. The ICI and NFMA suggested that the SMMP concept should not apply to transactions in private placement securities and securities exempt from the disclosure requirements of the Act's Rule 15c2–12, such as variable rate demand obligations (collectively ''exempt securities'').[75] The ICI stated, ''the premise underlying the SMMP concept, *i.e.*, that information about a security is already disclosed generally to the public, is particularly inapplicable to these securities. Because updated information on exempt securities is not required, it would be illogical and potentially harmful to investors to permit them to be traded on an electronic platform.'' [76]

MSRB Response. The MSRB has determined not to exempt certain types of municipal securities from the application of the SMMP proposal. The ICI's and NFMA's comments are based upon a fundamental misunderstanding of the underpinnings of the SMMP concept. What underlies the SMMP concept is not that material information is always disclosed to the public by the

[70] *See supra* notes 31–32 and accompanying text.

[71] MuniCenter also indicated some confusion about implications in the SMMP proposal, stating that the ''SMMP Interpretive Guidance implies that electronic trading platforms are limited to transaction execution.'' Additionally, MuniCenter stated, ''there should not be an implication that if an institutional investor does not have the level of assets in the definition of SMMP, the institutional investor should be foreclosed from electronic trading when the platform is providing significant informational services beyond transaction execution.'' MuniCenter, *supra* note 23. However, the MSRB's statements have been taken out of context. The MSRB's intent was to recognize the need for SMMP designation because some ATS type systems are being developed as largely transaction execution systems. Such systems may not provide sufficient information about the securities traded, and may not take reasonable steps to ensure that the transaction prices are fair and reasonable (nor do they represent that they perform these functions). The MSRB believes that these types of systems that are limited to transaction execution services should limit access to SMMPs, or at least that the dealer-operator of such systems should be aware that they are obligated to provide affirmative disclosure under rule G–17 and reasonably ensure fair and reasonable transaction prices under rule G–18 for the non-SMMP customers who transact directly within such a system. However, the MSRB believes and has stated that non-SMMP customers should not be foreclosed from electronic trading platforms that provide sufficient informational services.

[72] *See* ICI II, *supra* note 23.

[73] For example, if an SMMP reviewed an offering of municipal securities on an electronic platform that limited transaction capabilities to broker-dealers and then called up a dealer and asked the dealer to place a bid on such offering at a particular price, the interpretation would apply because the dealer would be acting merely as an order taker effecting a non-recommended secondary market transaction for the SMMP.

[74] *See* First Southwest II, MuniCenter and TBMA III, *supra* note 23.

[75] *See* ICI II and NFMA II, *supra* note 23.

[76] *Id.*

issuer, but rather, that the SMMP is aware of, or capable of making itself aware, and can independently understand the significance of, the material facts available from established industry sources. The interpretive notice recognizes that there ''may be times when an SMMP is not satisfied that the information available from established industry sources is sufficient to allow it to make an informed investment decision. However, in those circumstances, the MSRB believes that an SMMP can recognize that risk and take appropriate action, be it declining to transact, undertaking additional investigation, or asking the dealer to acquire additional information.''

The MSRB understands that the ICI and NFMA believe that SMMPs generally obtain information about exempt securities through dealers.[77] However, the MSRB is concerned that the commentators may be confusing the role of a dealer effecting primary market transactions for SMMPs, with a dealer that is acting as an order taker effecting non-recommended secondary market transactions for an SMMP. While a dealer acting on behalf of an issuer may have more information about a municipal security than an SMMP, there is no reason to assume that a dealer effecting a non-recommended secondary market transaction would have the same informational advantage.[78] Nonetheless, the SMMP interpretation states that ''if material information is not accessible to the market but known to the dealer and not disclosed, the dealer may be found to have engaged in an unfair practice.'' [79] Continuing to impose rule G–17's affirmative disclosure obligations on dealers transacting with SMMPs will not necessarily create the desired additional information since disclosure information must come from the issuer, not the dealer. In fact, it should be recognized that a dealer operating an ATS is likely to have very little information concerning the security in question if, for example, an institutional customer offers the security for sale through the ATS.

Miscellaneous

Comments Received. MuniCenter and UBSPW both expressed the view that the MSRB should issue definitive guidance about online recommendations.[80] MuniCenter recognized that the MSRB is reserving its guidance on the definition of an online recommendation, but ''would like to state our view that an electronic platform listing securities input by institutional sellers and buyers, or the results displayed by a user's defined search criteria are not a recommendation by the platform.'' UBSPW stated, that the ''only way the MSRB can achieve its goal of permitting sophisticated institutional investors to participate in electronic trading platforms 'on par with dealers when engaging in non-recommended secondary market transactions' is to make absolutely clear that the posting of line items coupled with a user-directed search feature and/or dealer controlled filter does not constitute the recommendation of any securities posted.'' [81]

MSRB Response. The MSRB will take these comments into consideration when it considers appropriate guidance concerning online recommendations.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the self-regulatory organization consents, the Commission will:

(a) by order approve such proposed rule change, or

(b) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Copies of the submissions, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing will also be available for inspection and copying at the MSRB's principal offices. All submissions should refer to File No. SR–MSRB–2002–02 and should be submitted by March 4, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[82]

Margaret H. McFarland,

Deputy Secretary.

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[77] The MSRB believes that disclosure information may also be available from established industry sources since many issuers of exempt securities (*e.g.*, VRDOs) are also issuers of Rule 15c2–12 issues and thus have Rule 15c2–12 disclosure obligations for those issues that are not exempt.

[78] Moreover, investors' comments may incorrectly assume that remarketing agents usually are effecting secondary market transactions in exempt securities (*i.e.* VRDOs). A ''primary offering'' is defined in Rule 15c2–12 to mean an offering directly or indirectly by an issuer. Many remarketings of VRDOs meet the definition of a ''primary offering'' under Rule 15c2–12(c). *See* Pillsbury, Madison & Sutro, SEC No-Action Letter, [1990–1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79, 659 at 78, 027 (Mar. 11, 1991) (cautioning the inquirer not to read the language of Rule 15c2–12(e)(7) too restrictively and instructing that each remarketing of exempt securities should be examined as though it were a new offering to determine if an exemption applies).

[79] The ICI's comment letter applauded the MSRB's clarification of this point in the July SMMP Guidance and recommended that the MSRB remind dealers ''of their duty not to mislead customers.'' ICI II, *supra* note 23.

[80] *See* MuniCenter and UBSPW, *supra* note 23.

[81] *Id.*

[82] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45387; File No. SR–NASD–2002–13]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to the Bid Price Criteria of Nasdaq Listing Standards

February 4, 2002.

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 January 17, 2002, the National Association of Securities Dealers, Inc. (''NASD''), through its subsidiary, The Nasdaq Stock Market, Inc. (''Nasdaq''), filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. Nasdaq has designated this proposed rule change as ''non-controversial'' pursuant to Rule 19b-4(f)(6) of the Act,[3] which renders it effective immediately upon

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

[2] 17 CFR 240.19b–4.

[3] 17 CFR 240.19b–4(f)(6).