



September 21, 2012

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

**Re: MSRB Notice 2012-41 (August 9, 2012): Request for Comment on
Concept Proposal to Strengthen Account Opening and
Supervisory Practices of Dealers Effecting Online Municipal
Securities Transactions with Individual Investors**

Dear Mr. Smith:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates the opportunity to comment on the Municipal Securities Rulemaking Board’s (“MSRB”) Concept Proposal to strengthen protections for individual investors by establishing new account opening and supervisory requirements for online municipal securities transactions with individual investors (the “Proposal”).

SIFMA generally supports the MSRB’s goals of increasing the likelihood that individual investors who trade municipal securities online understand the features and risks of such investments. However, we object to certain key aspects of the Proposal and suggest more reasonable alternatives to achieve stated objectives as described in more detail below. In summary:

- MSRB should not require delivery of municipal securities educational materials to *all* new individual investors within 10 days of account opening because only a very small percentage of individual investors opening online brokerage accounts purchase municipal securities and standard educational materials on the risks and features of municipal securities are already made publicly available by the MSRB.
- In circumstances where an electronic brokerage has made a recommendation, the investment profile information required to be obtained and considered

¹ SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

under MSRB Rule G-19 should be made consistent with the profile information required by FINRA Rule 2111 and SEC Rule 17a-3(a)(17)(i)(A).

- A requirement to have a municipal securities principal approve accounts of individual investors in advance of their first municipal securities transaction is impractical and ineffectual given the difficulty of predicting the timing of an initial self-directed online transaction. The only alternative is to review and approve all new accounts, the great majority of which will not engage in online municipal securities transactions. Further, a general securities principal is more than capable of performing this function.
- Individual investors should be made aware of on-line subscriptions to MSRB email alerts; however, enrollment should be effected directly through the MSRB rather than electronic brokerages. Electronic brokerages should not be required to collect individual investors' email addresses and enroll them in an EMMA alert service. Mandating that all electronic brokerages enroll customers in the EMMA alert service introduces significant technology complexity and potentially makes electronic brokerages liable for technology failures outside of their control.

Additionally, SIFMA members believe the MRSB should revisit MSRB Notice 2002-30² (the "2002 Notice") regarding what constitutes a "recommendation" in light of FINRA's recent changes to its Suitability rule (FINRA Rule 2111), FINRA's reaffirmation of its guidance on what constitutes a "recommendation" in the online context³, as well as the evolution and expansion of municipal securities offerings through alternative trading systems, other online trading platforms, and technological advances over the past decade.⁴ Specifically, the MSRB should acknowledge that, while the market for municipal securities by its nature may be more limited than the equities market, that fact alone is not dispositive of a whether a "recommendation" has been made. Rather, in keeping with longstanding FINRA and MSRB guidance, determining whether a communication is a "recommendation" is a facts and circumstances inquiry to be conducted on a case-by-case basis that considers, among other factors, whether a customer would reasonably view a communication as a "call to action" due to the fact the communication was individually tailored to the customer or a targeted group of customers.

² MSRB Notice 2002-30 (September 25, 2002): Notice Regarding Application of Rule G-19, on Suitability of Recommendations and Transactions, to Online Communications, available at <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2002/2002-30.aspx?n=1>

³ FINRA Regulatory Notice 12-25, Suitability: Additional Guidance on FINRA's New Suitability Rule (May 2012), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p126431.pdf>

⁴ The Securities and Exchange Commission recently noted that alternative trading systems (ATS) have come to play an important role in the municipal bond market by aggregating liquidity. (*See* Securities Exchange Commission *Report on Municipal Securities Market* at 45, July 31, 2012 (hereinafter the "SEC Report"), available at <http://sec.gov/news/studies/2012/munireport073112.pdf>). *See also* Jonathan Hemmerdinger, *As E-Brokerage Expands, MRSRB Looks Out for Retail Buyers*, *The Bond Buyer*, May 29, 2012, at 1.

In the event that the MSRB intends to pursue formal rulemaking to adopt the measures outlined in the Proposal, SIFMA urges the MSRB to conduct a thorough cost-benefit analysis of all components of the Proposal. Implementation, as currently proposed, would impose undue costs on electronic brokerages and may result in some online firms discontinuing altogether the availability of municipal securities to their retail customers, negatively impacting liquidity in this market.

I. The MSRB should not require delivery of municipal securities educational materials to all new individual investors within 10 days of account opening

A. Only a small percentage of individual investors opening online brokerage accounts purchase municipal securities

The Proposal's requirement for electronic brokerages to deliver educational materials to *all* new individual investors within 10 days of account opening would result in millions of new individual online brokerage customers receiving extensive disclosure information that, in the vast majority of cases, would be irrelevant to their investment activity.⁵ Mandatory delivery of this information would be expensive for electronic brokerages to effect and would be confusing and bothersome for new investors to receive given the already voluminous amounts of disclosure information required to be provided in connection with opening a new brokerage account. Moreover, no other category of security has a comparable requirement other than when a customer indicates a desire to trade standardized options contracts, which may be highly speculative by nature, and even here the requirement only applies for those accounts specifically indicating a desire to trade options. Municipal securities would be singled out for extensive proactive, mandatory disclosure and education to customers who have not indicated any interest in them and for whom they may well be unsuitable in any event. The MSRB has not stated, and we do not believe there is, any specific reason why municipal securities should be treated differently than every other security in this context.⁶

⁵ Although some widely repeated figures seem to indicate that individual investors may hold about two thirds of individual municipal bonds, either directly or through mutual funds and other pooled investments, more recent Federal Reserve Board data shows that the percentage of families with directly held bonds has steadily declined from over 5% in 1990 to 1.6% in 2010 (*see* Board of Governors of the Federal Reserve System, Survey of Consumer Finances, available at <http://www.federalreserve.gov/econresdata/scf/scfindex.htm>). Estimates provided by one large electronic broker that is active in both electronic brokerage and the sale of municipal securities appear to reflect the Federal Reserve Board's figures, indicating less than 0.1% of its brokerage customers purchase individual municipal securities (e.g., municipal bonds) through online transactions (i.e., without registered representative assistance). It is possible these seemingly disparate figures as well as others related to the use of professional investment advisers merely indicate that most individual municipal securities owned by individual "retail" investors may be very highly concentrated in relatively few households, and many of those may be purchased with the assistance of investment professionals.

⁶ *See* Securities and Exchange Commission *Study Regarding Financial Literacy Among Investors*, August 2012, available at <http://sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf>

B. Standard educational materials are already made available by the MSRB

The Proposal seems to contemplate that each electronic broker would create its own educational materials covering the broad set of topics listed. This would necessarily result in disparate treatment of investors due to the varied detail and accuracy contained in materials developed by different firms. In the Proposal, the MSRB expressed concern regarding non-uniform practices in related contexts,⁷ and we believe that consistency of information is an equally relevant consideration in connection with the provision of educational materials.

Rather than requiring different firms to create their own materials, a more workable arrangement would be to have electronic brokerages provide potential investors in municipal securities with meaningful awareness of, or access to, the abundance of high-quality educational materials already made publicly available by the MSRB. For example, on May 30, 2012, the MSRB announced the launch of an Online Investor Toolkit providing investors with “free, objective and independent information about how the municipal market works.” The online toolkit includes a 12-page Investor Guide on municipal securities with hyperlinks to more detailed information throughout the document, as well as fact sheets about the disclosures and services available through the MSRB’s [Electronic Municipal Market Access](#) (EMMA®) website. In addition, the EMMA website has an “Education Center” section with substantial educational information on municipal securities as well as instruction on how to navigate and understand the tools and information on EMMA. We believe this model would also be consistent with the required delivery of educational materials on the characteristics and risks of standardized options, whereby the disclosure content is created and maintained by a self-regulatory organization (the Options Clearing Corporation).

Under this alternative, electronic brokerages could provide direct hyperlinks or prominent instructions to access MSRB resources through firm website pages already dedicated to municipal securities disclosure content through a Notice and Access model.⁸ Those investors interested in becoming more educated could easily access uniform and accurate educational materials on the features and risks of municipal securities. The MSRB has previously embraced the concept of “access equals delivery” with respect to issuer disclosure documents in order to speed investor access and reduce overall costs. The small segment of individual investors who enter municipal securities transactions online is sophisticated and web-savvy enough to access the MSRB information through hyperlinks provided by electronic brokerages. If the MSRB believes educational information currently available should be further consolidated or enhanced to address more completely each area outlined in the proposal, SIFMA would be pleased to contribute to a review effort through the formation of industry working group.

⁷ See the Proposal at page 4 of 10 concerning firm inventory restrictions and access to material information.

⁸ See SEC Release No. 34-56135 (January 1, 2008) regarding shareholder choice with respect to proxy materials, available at <http://www.sec.gov/rules/final/2007/34-56135.pdf>.

II. Investor profile information required under MSRB Rule G-19 should be consistent and harmonized with FINRA Rule 2111

The MSRB would require an electronic broker to use reasonable efforts to obtain information about an individual investor's investment profile required by MSRB Rule G-19 unless it determines that none of the transactions executed for the individual investor would be recommended.

The profile information required by Rule G-19 includes the customer's financial status; the customer's tax status; the customer's investment objectives; and such other information used or considered to be reasonable and necessary by such electronic broker in making recommendations to the customer. The "other information" includes: age; annual income, source of income, net worth (exclusive of primary residence), liquid assets; years of investment experience in municipal securities and other fixed income securities; and risk tolerance. SIFMA notes that this profile information is the same information that formerly was required under NASD Rule 2310, prior to the adoption and implementation of new FINRA Rule 2111.

Under FINRA Rule 2111 broker-dealers recommending a transaction or investment strategy involving a security or securities, including municipal securities, are required to consider a customer's investment profile which includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation. Additionally, SEC Rule 17a-3(a)(17)(i)(A) requires broker-dealers to maintain certain account records related to having made a suitability determination.

The brokerage industry only just recently concluded a multi-year effort including millions of dollars in capital investment to enhance customer facing and back office recordkeeping systems to ensure compliance with FINRA Rule 2111, including the collection and retention of standard investment profile data points. Given the absence of any rationale for requiring firms to collect different data elements from those required by FINRA Rule 2111, we request the MSRB amend the Rule G-19 investment profile requirements and interpretive guidance to be consistent with FINRA Rule 2111.

III. Municipal securities principal approval of accounts in advance of the first municipal securities transaction is an impractical and ineffectual requirement

The MSRB proposes to require electronic brokerages to have a municipal securities principal review and approve any new individual investor customer account in advance of the first municipal securities transaction. This requirement is impractical and ineffectual. The Proposal is intended to address transactions entered online, and it would be impossible to predict the timing of a customer's initial online transaction in a municipal

security. As a result, dealers would be faced with two alternatives: either (1) systematically block municipal securities transactions prior to account approval; or (2) have *all* new individual investor accounts reviewed and approved by a municipal securities principal, even if the customer might never trade municipal securities or never trade online at all. The first alternative would involve significant expense for systems enhancements and transaction delays could potentially harm customer in connection with lost investment opportunity or execution pricing. The second alternative is untenable given the very small percentage of individual investors who purchase municipal securities online. Moreover, a general securities principal has the requisite skills and abilities to perform the tasks proposed by the MSRB; licensing as a municipal securities principal should not be required to determine whether a firm has provided educational materials or collected the relevant customer profile information.

IV. On-line subscriptions to MSRB email alerts should be effected directly through MSRB

We agree that MSRB-generated email alerts are a valuable resource for municipal security investors, and we agree generally with the goal of making customers aware of the option to subscribe to MSRB-generated email alerts of continuing disclosures submitted to EMMA pertaining to the particular municipal securities purchased. However, we believe requiring dealers to act as an ongoing conduit for those alerts adds unnecessary complexity, burden and potential for failure. A better approach would be to have electronic brokerages provide customers with information about how to subscribe to alerts directly through EMMA and the MSRB. It would be unduly burdensome to expect electronic brokerages to perform email enrollment, update address information, and/or directly facilitate delivery of alerts due to the challenges and expense associated with attempting to synchronize technology platforms and maintain that electronic interface with EMMA going forward.

Many electronic dealers offer data services to their customers, including providing information and data supplied by third party data vendors, such as the former Nationally Recognized Municipal NRMSIR effective July 1, 2009. As stated in SEC Release No. 34-59061, the MSRB asserted that nothing in the MSRB's proposal will prevent the NRMSIRs from continuing to make historical information available. The MSRB also responded that it did not believe that the proposed rule change would impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The MSRB expressed its belief that existing vendors would continue to have rapid access to all of the same documents they previously received, now accompanied by consistent indexing information, and would fully be able to provide value added products based on such documents. Mandating that electronic dealers enroll customers in the MSRB's data service seems contradictory to these previous statements.

Additionally, mandating that dealers enroll customers in the MSRB's service would introduce significant technological complexity and require the information platforms of all dealers to build new systems to successfully interface with the EMMA system. Such a

requirement might also make these dealers liable for third-party technology problems that are outside of their control.

As suggested above, in connection with providing access to educational materials, if electronic brokerages were to provide direct hyperlinks or prominent instructions on how to subscribe to MSRB-generated alerts through firm website pages already dedicated to municipal securities disclosure content, those investors interested in receiving such communications could easily sign-up and independently maintain their personal account information through EMMA.

V. Electronic brokerages should have written supervisory procedures addressing the matters proposed by MSRB

SIFMA generally supports the proposal that electronic brokerages should have written supervisory procedures to demonstrate how they fulfill their obligation to deliver material information about municipal securities transactions to individual investors under MSRB Rule G-17, and how they fulfill their fair pricing obligations under MSRB Rules G-18 and G-30. Additionally, if electronic brokerages are making recommendations, supervisory procedures should describe how suitability obligations are being fulfilled pursuant to MSRB Rule G-19. We believe that firms would take such firm-specific considerations into account in determining what constitutes a recommendation, and we do not understand MSRB to be suggesting otherwise. We also note, there are many electronic brokerages that do not make any recommendations and accordingly, they would not have supervisory procedures covering Rule G-19, nor should they be required to do so.

VI. Only certain online transactions are a result of a recommendation

In the 2002 Notice, the MSRB viewed the following communications as falling within the definition of recommendation:

- A dealer sends a customer-specific electronic communication (e.g., an e-mail or pop-up screen) to a targeted customer or targeted group of customers encouraging the particular customer(s) to purchase a municipal security.
- A dealer sends its customers an e-mail stating that customers should be invested in municipal securities from a particular state or municipal securities backed by a particular sector (such as higher education) and urges customers to purchase one or more stocks from a list with "buy" recommendations.
- A dealer provides a portfolio analysis tool that allows a customer to indicate an investment goal and input personalized information such as age, financial condition, and risk tolerance. The dealer in this instance then sends (or

displays to) the customer a list of specific municipal securities the customer could buy or sell to meet the investment goal the customer has indicated.

- A dealer uses data-mining technology (the electronic collection of information on Web Site users) to analyze a customer's financial or online activity—whether or not known by the customer—and then, based on those observations, sends (or "pushes") specific investment suggestions that the customer purchase or sell a municipal security.

While we understand these examples were only meant to provide guidance and are not an exhaustive list of communications that the MSRB considers "recommendations," they have served as concrete examples of the "general principles" cited by the MSRB to assist electronic brokerages in determining whether a communication, when analyzing all relevant facts and circumstances, is a recommendation.

SIFMA's members strongly believe that, absent one of the "general principles" included in the 2002 Notice, or other similar "call to action" communications, making available alternative trading systems that provide user interface screens that permit investors to search for municipal securities by feature, conduct research, and enter orders to purchase or sell municipal securities (commonly referred to as "white label" products) is not conclusive that a recommendation has been made. An electronic brokerage that simply makes available thousands of municipal securities from one or more of the fixed income alternative trading systems⁹ cannot be said to be recommending all of them solely because it is impossible to offer every municipal security in existence. FINRA's longstanding seminal guidance¹⁰ regarding online suitability is certainly appropriate in the context of offering of all securities through an online trading platform, including municipal securities. Merely informing online customers that municipal securities are available through the firm's website does not confer a "call to action" to the customer. This is no different than listing other securities that are available for purchase. FINRA appropriately recognized in 2001 that, so long as the member firm does not seek to steer a client to one of the "wide universe of securities" it offers, then no "recommendation" can possibly have been made. The member firm is not affirmatively providing any investment advice to the online client; the business model of self-directed client trading is that no such advice is ever rendered by the member firm. The manner in which municipal securities are in fact traded by dealers and brokers (i.e., through an over-the-counter market), or the liquidity of such securities, makes no difference to the question of

⁹ SEC Report at 45. Additionally, the SEC notes, "ATS account for a substantial portion of municipal securities transactions but represent only a small percentage of the dollar volume, which supports the premise that they are used primary for smaller, retail-size orders." (See *Id* at 118).

¹⁰ NASD Notice to Members 01-23, Online Suitability: Suitability Rule and Online Communications, April 2001, available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003887.pdf>

whether the member firm has issued a “call to action” to its clients by listing municipal securities as available for purchase or sale.

VII. Additional specific questions

A. The MSRB should not require online training be provided to individual investors

We object to the proposal to require online training of individual investors who purchase municipal securities online. Certain electronic brokerages may make available interactive tools or videos concerning the features and risks on municipal securities. However, these are optional resources for investors to use at their discretion and we are opposed generally to the notion that a regulator would mandate a training requirement for investors. This requirement would be a frustrating annoyance for sophisticated customers, especially those who have accounts with multiple firms. No other category of security has a similar requirement.

B. Municipal fund securities should not be subject to proposed requirements

If any of the requirements set forth in the Proposal are formally proposed by the MSRB, none should apply to investments in municipal fund securities given the significantly less complicated features and generally lower risks associated with those products when compared to individual municipal securities products such as municipal bonds.

Additionally, investors are already receiving extensive disclosure regarding municipal fund securities including Qualified Tuition Plans issued pursuant to section 529 of the Internal Revenue Code and regulations thereunder (529 Plans). Therefore, to the extent the MSRB moves forward with the Proposal, 529 Plans should be exempt. For example, MSRB Rule G-32 requires dealers to provide copies of the official statements to the investors by the transaction settlement date. The official statements contain many details about a particular 529 Plan including, but not limited to, potential risks, underlying investments, fees, and tax implications. Additionally, the MSRB’s EMMA contains filings of these official statements which can be accessed by the public including prospective investors. Moreover, industry practice is to provide online, in marketing materials and in other venues, important information about 529 Plans that investors can access prior to purchase. This information generally includes disclosures relating to the suitability and certain risks of the particular 529 Plan as well as references to the Plan’s official statement where more complete information is available. Requiring further disclosure to investors as proposed would be redundant, would not provide incremental value to the investor in connection with the investor’s purchase of a 529 Plan, and would be overly burdensome for dealers.

VIII. Cost Benefit Analysis

SIFMA urges the MSRB to conduct a cost benefit analysis of all of the components of the proposal. Implementation, as currently proposed, would impose undue costs on electronic brokerages and may result in some discontinuing offering municipal securities to their retail customers negatively impacting liquidity in this market.

IX. Conclusion

SIFMA sincerely appreciates this opportunity to comment upon the Proposal. SIFMA supports the MSRB's initiatives to promote greater likelihood that individual investors who trade municipal securities online understand the features and risks of such investments. However, we have significant reservations regarding certain requirements and ask the MSRB to carefully consider the objections and suggested alternatives noted above.

We would be happy to meet with you to further discuss all aspects of the issues raised in Notice 2012-41 and the comments contained herein. Please do not hesitate to contact me with any questions at (212) 313-1265.

Sincerely yours,



David L. Cohen
Managing Director
Associate General Counsel

CC: Lynnette Kelly, Executive Director
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