

# FAQs Regarding MSRB Rule G-42 and Making Recommendations

The Municipal Securities Rulemaking Board (MSRB) is providing these answers to frequently asked questions and related scenarios (FAQs) as a compliance resource to enhance understanding of provisions of [MSRB Rule G-42](#), on duties of non-solicitor municipal advisors, related to making “recommendations,” and related provisions of MSRB Rule G-8, on books and records.

The principles discussed in this compliance resource were established in the MSRB’s regulatory filings associated with the development of Rule G-42. **The MSRB stresses that these FAQs do not create new legal or regulatory requirements, or new interpretations of existing requirements.** The MSRB does not intend these FAQs to be interpreted by municipal advisors or examining authorities as establishing new standards of conduct.

The examples and considerations in the following FAQs are designed to assist municipal advisors with compliance with applicable MSRB rules, and municipal advisors may be able to use them as a resource in tailoring compliance and supervisory programs to their business.<sup>1</sup> However, the MSRB does not require municipal advisors to implement any specific practices described in this resource that extend beyond the requirements of existing MSRB rules and applicable federal securities laws. These FAQs were developed with input from municipal advisors and other market participants.<sup>2</sup>

Unless otherwise noted, these FAQs **assume** that the communications considered herein for illustration purposes constitute “advice” for purposes of Rule G-42 and Section 15B of the Securities Exchange Act of 1934 (“Exchange Act”) and the rules and regulations thereunder. In other words, these FAQs do not attempt to provide guidance concerning whether a given communication is, or is not, advice for these purposes.

The obligations under Rule G-42 outlined in these FAQs also apply, consistent with [MSRB Rule D-11](#), to the municipal advisor firm’s associated persons who engage in municipal advisory activities on its behalf.

## FREQUENTLY ASKED QUESTIONS ABOUT THE DISTINCTION BETWEEN ADVICE AND A RECOMMENDATION UNDER MSRB RULE G-42 BY A NON-SOLICITOR MUNICIPAL ADVISOR

### 1. Why is it necessary in understanding Rule G-42 to distinguish between providing advice and providing a recommendation?

It is necessary to recognize whether the advice a municipal advisor provides includes a recommendation within the meaning of Rule G-42 (for purposes of these FAQs, “G-42 Recommendation”) because Rule G-42 imposes specified obligations on the municipal advisor when making a G-42 Recommendation. These obligations include the requirement, pursuant to Rule G-42(d), to undertake an analysis to determine that the G-42 Recommendation is suitable for the municipal entity or obligated person (hereinafter “MA Client” unless otherwise specified) based on the information the municipal advisor obtained through its reasonable diligence.

Relatedly, when making the requisite suitability determination for a G-42 Recommendation, Rule G-8(h) (iv) requires a municipal advisor to maintain a copy of any document created by the municipal advisor “that memorializes the basis for any determination as to suitability.”<sup>3</sup> In addition, if the MA Client is a municipal entity, the municipal advisor’s duty of loyalty imposes an additional, higher standard than that of suitability, as the duty of loyalty requires that the municipal advisor’s G-42

<sup>1</sup> See [MSRB Rule G-44](#), on supervisory and compliance obligations of municipal advisors.

<sup>2</sup> See [Request for Input on Draft Frequently Asked Questions Regarding Rule G-42 and the Making of Recommendations](#) (February 15, 2018).

<sup>3</sup> This recordkeeping obligation would also apply when reviewing a recommendation of another party to determine if the third-party’s recommendation is or is not suitable for the MA Client, if such review is requested by the MA Client and within the scope of the engagement.

Recommendation, like all advice provided to a municipal entity, be in the MA Client's best interests without regard to the financial or other interests of the municipal advisor.<sup>4</sup>

As the MSRB stated in response to public comments during the development of Rule G-42, these additional requirements provide safeguards that are "necessary to promote the integrity of the municipal advisory relationship and protect clients from the potentially costly consequences of transactions undertaken based on unsuitable recommendations."<sup>5</sup>

## 2. Rule G-42 uses the term "advice" in certain provisions and the term "recommendation" in other provisions. How are these terms defined for purposes of Rule G-42?

**Advice.** Rule G-42(f)(1) defines the term "advice" to have the same meaning as the term has when used in Section 15B of the Exchange Act and the rules and regulations thereunder.<sup>6</sup> Accordingly, if a communication would constitute advice under the Exchange Act and rules and regulations thereunder for purposes of applying the definition of "municipal advisor,"<sup>7</sup> then that communication would be advice for purposes of Rule G-42.<sup>8</sup>

The SEC has noted that, for purposes of the definition of a municipal advisor, the term "advice" includes, without limitation, a recommendation that is particularized to the specific needs, objectives or circumstances of an MA Client with respect to municipal financial products or the issuance of municipal securities, including with respect to the structure, timing, terms and other similar matters concerning such financial products or issues, based on all the facts and circumstances.<sup>9</sup> However, the SEC has indicated it does not believe "the term 'advice' is susceptible to a bright-line definition . . . [but instead] can be construed broadly and that, therefore, the determination of whether a person provides advice to or on behalf of a municipal entity or an obligated person regarding municipal

financial products or the issuance of municipal securities depends on all the relevant facts and circumstances."<sup>10</sup>

**Recommendation.** Rule G-42 does not specifically define the term "recommendation" or the phrase "recommendation of a municipal securities transaction or municipal financial product."<sup>11</sup> However, in order for a communication by a municipal advisor to be a G-42 Recommendation, it must, as a threshold matter, be advice and that advice must meet *both* prongs of a two-prong analysis. First, the advice must exhibit a call to action to proceed with a municipal financial product or an issuance of municipal securities and second, the advice must be specific as to what municipal financial product or issuance of municipal securities the municipal advisor is advising the MA Client to proceed with.

The MSRB emphasized in the Rule G-42 rulemaking record that there are communications that are *with respect* to an issuance of municipal securities or a municipal financial product that would constitute advice as the term is used in Section 15B of the Exchange Act and the rules and regulations thereunder and thus are advice under Rule G-42, but would not constitute advice to proceed with a *specific* municipal securities transaction or municipal financial product. As a result, while such advice would be subject to many provisions of Rule G-42, the suitability obligations of Rule G-42(d) would not be triggered.<sup>12</sup> For example, if the structure, timing and terms of a transaction are otherwise established, and before going to market, the municipal advisor advises the issuer to obtain bond insurance for the issuance, the advice to purchase bond insurance would be advice *with respect* to the terms of the issuance of municipal securities. However, the advice to purchase bond insurance would not be a G-42 Recommendation because it is not a call to action to proceed with a specific issuance of municipal securities or a municipal financial product.

<sup>4</sup> Rule G-42, Supplementary Material .02, Duty of Loyalty. See also, *infra* FAQ 9.

<sup>5</sup> See [MSRB Response to Comments](#), dated December 16, 2015, p. 48.

<sup>6</sup> See [Registration of Municipal Advisors](#), Release No. 34-70462 (September 20, 2013), 78 FR 67467 (November 12, 2013) ("SEC Adopting Release").

<sup>7</sup> Exchange Act Section 15B(e)(4)(A)(i) defines a municipal advisor, other than a solicitor municipal advisor, as "a person (who is not a municipal entity or any employee of a municipal entity) that . . . provides advice to or on behalf of a municipal entity or obligated person **with respect** to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues . . ." *Emphasis added.*

<sup>8</sup> Exchange Act Rule 15Ba1-1(d)(1)(ii) establishes an advice standard noting that, for purposes of the municipal advisor definition, advice excludes, among other things, the provision of general information that does not involve a recommendation regarding municipal financial products or the issuance of municipal securities (including with respect to the structure, timing, terms and other similar matters concerning such financial products or issues). The SEC has provided certain examples of general information, including information of a factual nature without subjective assumptions, opinions, or views, and information that is not particularized to a specific municipal entity or type of municipal entity. See SEC Adopting Release at 67479.

<sup>9</sup> See SEC Adopting Release at 67480. Put differently, a recommendation is a form of advice, but not all advice is a recommendation.

<sup>10</sup> See SEC Adopting Release at 67479; see also, [Registration of Municipal Advisors Frequently Asked Questions](#).

<sup>11</sup> In this context, the recommendation of a municipal securities transaction means the recommendation of an issuance of municipal securities.

<sup>12</sup> See File No. SR-MSRB-2015-03, 80 FR 26752 (May 8, 2015) (Notice of filing of proposed rule change regarding proposed new Rule G-42 and proposed amendments to Rule G-8) ("Initial Rule Filing") at 26756.

### 3. How does one determine when a municipal advisor's advice constitutes a G-42 Recommendation?

Determining whether advice constitutes a G-42 Recommendation requires a two-pronged analysis. First, does the nature and specificity of the advice to or on behalf of the MA Client include elements generally present in a communication considered a "call to action" to proceed; and second, is the municipal advisor advising the MA Client to proceed with a specific municipal financial product or issuance of municipal securities.

There are instances, of course, where advice given would not constitute a G-42 Recommendation because the advice does not meet both prongs of the two-pronged analysis — 1) a call to action to proceed and 2) specificity as to the municipal financial product or issuance of municipal securities.<sup>13</sup> For example, assume a communication by a municipal advisor to an MA Client advising the MA Client to review and consider three alternative offerings as a model for the MA Client's next issuance is advice under SEC rules and, therefore, advice for purposes of Rule G-42. This advice is not a call to action to proceed with a specific municipal financial product or a specific issuance of municipal securities and, therefore, it would not constitute a G-42 Recommendation even though the communication may constitute advice for purposes of the SEC rules and Rule G-42.

### 4. How can a municipal advisor determine if the first prong of the two-pronged analysis has been met (i.e., it has given advice to or on behalf of an MA Client that includes a "call to action" to proceed with a municipal securities issuance or municipal financial product)?

As noted above, these FAQs assume that the municipal advisor's communication has been deemed advice as the term is used in Section 15B of the Exchange Act and the rules and regulations thereunder.<sup>14</sup>

The MSRB explained in the Rule G-42 rulemaking record that to assess whether advice to an MA Client reasonably would be viewed as a call to action, municipal advisors should apply the same principles the MSRB previously outlined for brokers, dealers and municipal securities

dealers (collectively, "dealers").<sup>15</sup> Specifically, the MSRB referred to guidance issued to dealers in 2002 with respect to obligations on suitability of recommendations because the guidance provides general principles for determining whether a dealer's communication to a customer constitutes a recommendation, and the MSRB stated that such principles are equally applicable to a municipal advisor's analysis with respect to advice to an MA Client.<sup>16</sup>

For example, the 2002 Dealer Guidance provides that, "the test for determining whether any communication ... constitutes a recommendation ... requires an analysis of the content, context, and presentation of the particular communication or set of communications" and to conduct such an analysis, one should examine "the underlying substantive information transmitted to the customer and consideration of any other facts and circumstances, such as any accompanying explanatory message."<sup>17</sup>

The 2002 Dealer Guidance also provides that "in general, the more individually tailored the communication is to a specific customer ... about a security or group of securities, the greater the likelihood is that the communication may be viewed as a recommendation" and whether, "given its content, context, and manner of presentation — a particular communication from a dealer to a customer reasonably would be viewed as a 'call to action,' or suggestion that the customer engage in a securities transaction."<sup>18</sup> These principles are equally applicable to municipal advisors for determining whether advice rises to the level of a G-42 Recommendation.<sup>19</sup>

### 5. How can a municipal advisor determine whether the second prong of the two-pronged analysis has been met (i.e., it has given advice to or on behalf of an MA Client to proceed with a specific municipal financial product or issuance of municipal securities)?

For advice to be considered a G-42 Recommendation, it must exhibit both a call to action and specificity as to what the municipal advisor is advising the MA Client to proceed with — a *specific* municipal financial product or a *specific* issuance of municipal securities. For example, a municipal advisor's advice to or on behalf of an MA Client that details

<sup>13</sup> While the advice in this example would not trigger suitability obligations under Rule G-42(d), such advice would trigger other provisions of the rule, such as a duty of care and a duty of loyalty, as applicable.

<sup>14</sup> See, *supra*, footnotes 7 and 8.

<sup>15</sup> See Initial Rule Filing at 26755-26756 and n. 18 (regarding call to action), at 26771-26772, 26775, 26776 (regarding suitability analysis). MSRB Response to Comments, dated December 16, 2015, p. 54 (regarding call to action and other general principles for determining whether a particular communication constitutes a recommendation).

<sup>16</sup> [MSRB Regulatory Notice 2002-30 \(September 25, 2002\)](#) ("2002 Dealer Guidance").

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> Consistent with the principles outlined in the 2002 Dealer Guidance, advice to take no action would not be a G-42 Recommendation.

a specific issuance of municipal securities and advises the MA Client to proceed with the offering is a G-42 Recommendation because it contains a call to action to proceed with a specified issuance of municipal securities.

Notably, general advice to an MA Client that is merely *regarding or with respect to or in connection with* a municipal financial product or the issuance of municipal securities, including advice as to the structure, timing, terms and other similar matters with respect to an issuance or municipal financial products, but that lacks a call to action to proceed with a specific transaction, would not be a G-42 Recommendation.<sup>20</sup>

Note that, depending on the particular facts and circumstances, there may be times when initial advice is not a G-42 Recommendation, but subsequent advice is a G-42 Recommendation because the context or content of that advice is a call to action to proceed with a specific municipal financial product or issuance of municipal securities based on the advice previously provided. For example, if a municipal advisor advises its MA Client on the structure and terms of an issuance of municipal securities that the MA Client should consider for its next financing, and several months later, the municipal advisor advises the MA Client that it should proceed with the described issuance, the later call to action is a G-42 Recommendation and the prior advice on the structure and terms of the issuance is the basis for that G-42 Recommendation. Accordingly, in this example, the municipal advisor's obligation to make a suitability determination and undertake a reasonable investigation to determine that it is not basing the recommendation on materially inaccurate or incomplete information would include an analysis of the advice on the structure and terms of the issuance because that advice was embedded in the G-42 Recommendation as the basis for the call to action.<sup>21</sup>

## 6. What are the obligations of a municipal advisor when making a G-42 Recommendation?

Making a G-42 Recommendation triggers a municipal advisor's obligation to make a suitability determination.<sup>22</sup> In determining suitability, a municipal advisor must have a *reasonable basis* to believe that the recommended

municipal securities transaction or municipal financial product is suitable for the MA Client, based on information obtained through the reasonable diligence of the municipal advisor. A determination of whether a municipal financial product or issuance of municipal securities is suitable generally must be based on numerous factors, as applicable to the particular type of MA Client. Supplementary Material .09 provides guidance on making suitability determinations and includes a non-exhaustive list of factors a municipal advisor is required to consider in making its suitability determination; and Supplementary Material .10 provides, in part, that a municipal advisor is required to use reasonable diligence to know and retain essential facts concerning the MA Client.<sup>23</sup>

"[T]he veracity of the information on which a municipal advisor bases its recommendation can have a significant impact on the ability of a municipal advisor to make informed and suitable recommendations."<sup>24</sup> Therefore, pursuant to its duty of care, a municipal advisor is required to undertake a reasonable investigation to determine that it is not basing a G-42 Recommendation on materially inaccurate or incomplete information.<sup>25</sup> Because the standard is one of reasonableness, a municipal advisor would not be required to go to impractical lengths to make such an investigation.<sup>26</sup>

After making a suitability determination, the municipal advisor is obligated, pursuant to Rule G-42(d), to inform the MA Client of:

- The municipal advisor's evaluation of the material risks, potential benefits, structure, and other characteristics of the recommended issuance of municipal securities or municipal financial product;
- The basis upon which the municipal advisor reasonably believes that the recommended issuance of municipal securities or municipal financial product is, or (as may be applicable in the case of a review of a third party's recommendation) is not, suitable for the client; and
- Whether the municipal advisor has investigated or considered other reasonably feasible alternatives to the recommended issuance of municipal securities

<sup>20</sup> See, *infra*, Scenario 2.

<sup>21</sup> See e.g., Rule G-42, Supplementary Material .01, Duty of Care.

<sup>22</sup> As noted above in FAQ 1, with respect to its municipal entity clients, as opposed to its obligated person clients, a municipal advisor must also ensure that its G-42 Recommendations comport with its fiduciary duty and particularly its duty of loyalty pursuant to Supplementary Material .02, Duty of Loyalty.

<sup>23</sup> See Initial Rule Filing at 26756 (discussing non-exclusive list of factors to conduct suitability analysis and know your customer requirements).

<sup>24</sup> See [MSRB Response to Comments](#), dated December 16, 2015, p. 48.

<sup>25</sup> Rule G-42, Supplementary Material .01, Duty of Care.

<sup>26</sup> See [MSRB Response to Comments](#), dated December 16, 2015, p. 48-49.



or municipal financial product that might also or alternatively serve the client's objectives.

Rule G-42(d) does not specify the method by which the municipal advisor must inform the MA Client. Rather, Rule G-42(d) provides a municipal advisor the flexibility to determine the appropriate method(s) for informing any particular MA Client, so long as the method used to inform the MA Client is consistent with the duty of care and, as applicable, duty of loyalty owed to the MA Client.

### 7. What are a municipal advisor's obligations to present additional information about reasonably feasible alternatives?

Under Rule G-42(d)(iii), the municipal advisor is obligated to *inform* its MA Clients *whether* it considered or investigated reasonably feasible alternatives to the G-42 Recommendation that it made to its MA Client that might also or alternatively serve the MA Client's objectives. Importantly, this provision does not require a municipal advisor to consider or investigate reasonably feasible alternatives, it only requires that the municipal advisor *inform* an MA Client whether it did consider or investigate reasonably feasible alternatives.<sup>27</sup> Again, the rule affords a municipal advisor the flexibility to determine the appropriate method(s) for informing any particular MA Client, so long as the method is consistent with the duty of care and, as applicable, duty of loyalty owed to the MA Client.

In addition, this provision does not require the municipal advisor to conduct a suitability analysis on any reasonably feasible alternative it considered or investigated or provide its MA Client with an exhaustive list of alternative financings together with its recommendation.<sup>28</sup> Note, however, that should the scope of the municipal advisor's engagement with an MA Client provide that the municipal advisor will undertake to consider or investigate reasonably feasible alternatives to a recommendation, then the municipal advisor would be obligated to take additional steps or present additional information to that MA Client about any reasonably feasible alternatives the municipal advisor considered or investigated.

### 8. How does the duty of care apply when making a G-42 Recommendation to or on behalf of an MA Client?

The duty of care is a core principle underlying many of Rule G-42's obligations, including the making of a G-42 Recommendation. Municipal advisors must undertake a reasonable investigation to determine that they are not basing any G-42 Recommendation on materially inaccurate or incomplete information.<sup>29</sup> The municipal advisor is required to investigate the accuracy and completeness of the information using reasonable diligence, but it is important to understand that reasonable diligence does not require the municipal advisor to go to impractical lengths to determine the accuracy and completeness of the information on which it bases a G-42 Recommendation.<sup>30</sup> For example, it would be relevant to the analysis of whether a municipal advisor conducted a reasonable investigation on the accuracy and completeness of the information if certain information was difficult to obtain, non-public, created or controlled by the MA Client, or otherwise was not accessible through reasonable diligence by the municipal advisor.

### 9. Is there any difference in the duties and obligations a municipal advisor owes when it makes a G-42 Recommendation to or on behalf of a municipal entity client versus an obligated person client?

Yes, while a municipal advisor making a G-42 Recommendation to either a municipal entity client or an obligated person client must be guided by the requirements and principles contained in the recommendation-related portions of Rule G-42,<sup>31</sup> the municipal advisor is subject to heightened standards as a fiduciary in its relationships with municipal entity clients.<sup>32</sup> A municipal advisor that makes a G-42 Recommendation to or on behalf of a municipal entity client is not only required to determine that the G-42 Recommendation is suitable based on a reasonable investigation and not based on any materially inaccurate or incomplete information, but also owes the municipal entity a duty of loyalty.<sup>33</sup>

The duty of loyalty applies to all municipal advisory activities in which the municipal advisor engages for or on behalf of a municipal entity client. The duty of loyalty

<sup>27</sup> See File No. SR-MSRB-2015-03, 80 FR 81614 (December 30, 2015) (Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1 and Amendment No. 2, Consisting of Proposed New Rule G-42, on Duties of Non-Solicitor Municipal Advisors, and Proposed Amendments to Rule G-8, on Books and Records to be Made by Brokers, Dealers, Municipal Securities Dealers, and Municipal Advisors) at 81625.

<sup>28</sup> See [MSRB Response to Comments](#), dated December 16, 2015, p. 55.

<sup>29</sup> See Rule G-42 Supplementary Material .01, Duty of Care.

<sup>30</sup> See [MSRB Response to Comments](#), dated December 16, 2015, p. 48-49.

<sup>31</sup> Rule G-42(d)(i)-(iii) and Supplementary Material .01, Duty of Care, Supplementary Material .02, Duty of Loyalty and Supplementary Material .09, Suitability.

<sup>32</sup> See also [MSRB Regulatory Notice 2017-13, dated July 13, 2017](#), wherein the MSRB provided guidance on duties of non-solicitor municipal advisors in conduit financings.

<sup>33</sup> See Rule G-42 Supplementary Material .02, Duty of Loyalty.

requires the municipal advisor to deal honestly and with the utmost good faith with a municipal entity client and act in the municipal entity client's best interests without regard to the financial or other interests of the municipal advisor. Thus, the duty of loyalty provides a heightened and more rigorous standard for municipal advisors in that any G-42 Recommendation to a municipal entity client of a specific municipal financial product or issuance of municipal securities must be in the client's best interests and without regard to any of the financial or other interests of the municipal advisor.<sup>34</sup>

#### **10. What are the duties and obligations related to recordkeeping under MSRB Rule G-8, on books and records, when a municipal advisor makes a G-42 Recommendation?**

Additional obligations under Rule G-8, on books and records, may be triggered when a municipal advisor makes a G-42 Recommendation. Recognizing that Rule G-42(d) requires a municipal advisor to make a suitability determination before making a G-42 Recommendation, Rule G-8(h)(iv), in part, requires a municipal advisor to maintain a copy of any document created by the municipal advisor "that memorializes the basis for any determination as to suitability."

It is important to remember that a municipal advisor has obligations to maintain and preserve books and records pursuant to the Exchange Act beyond its obligations under Rule G-8. Specifically, SEC Rule 15Ba1-8(a)(4) under the Exchange Act requires a municipal advisor to maintain a copy of any document created that was material to making a recommendation to an MA Client or that memorializes the basis for that recommendation. This obligation under the Exchange Act would, therefore, be applicable to a G-42 Recommendation, but is not limited to a G-42 Recommendation.<sup>35</sup>

#### **11. If an MA Client requests that a municipal advisor review a third party's recommended municipal financial product or issuance of municipal securities, is it considered a G-42 Recommendation when the municipal advisor informs the MA Client whether the third party's recommended product or issuance is, or is not, suitable?**

No, it is not a G-42 Recommendation if the municipal advisor's advice is limited to advising the MA Client, after conducting the review required pursuant to Rule G-42(d),

that the third party's recommended municipal financial product or issuance is, or is not, suitable. In that case, the advice would not be a G-42 Recommendation because the advice is not a call to action to proceed with a specific municipal financial product or issuance of municipal securities.

However, if an MA Client requests a review of a third party's recommendation of a municipal securities transaction or municipal financial product and the review is within the scope of the engagement, the municipal advisor's review and evaluation of the third party's recommendation is subject to obligations that are similar to the obligations that exist when the municipal advisor makes a G-42 Recommendation. For instance, the municipal advisor must conduct a suitability analysis, which requires the municipal advisor to use reasonable diligence to obtain information to determine whether the municipal securities transaction or municipal financial product recommended by the third party is, or is not, suitable for the MA Client. As part of the suitability analysis, the municipal advisor must inform the MA Client of, among other things, the basis upon which the municipal advisor reasonably believes that the recommended municipal securities transaction or municipal financial product is, or is not, suitable for the MA Client.<sup>36</sup>

In addition, Rule G-8(h)(iv) requires a municipal advisor to maintain a copy of any document created by the municipal advisor that was material to its review of a recommendation by another party and, to the extent such document does not also memorialize the basis for determining whether the third-party recommendation is or is not suitable for the MA Client, a copy of any document created by the municipal advisor that memorializes the basis for its determination that the third-party recommendation is or is not suitable for the MA Client.

#### **12. When reviewing a third party's recommended municipal financial product or issuance of municipal securities, is it a G-42 Recommendation when the municipal advisor provides an alternative?**

If a municipal advisor informs an MA Client on the suitability of a third party's recommendation and also advises the MA Client on one or more alternative municipal financial products or the issuance of municipal securities, such communication could be, depending on the characteristics of the advice, a G-42 Recommendation.

<sup>34</sup> See Initial Rule Filing at 26755, n. 17 (regarding the duty of loyalty).

<sup>35</sup> As noted above, a G-42 Recommendation is unique in that it is advice that includes a call to action to proceed with a specific municipal financial product or issuance of municipal securities. Advice that lacks specificity regarding a municipal financial product or issuance of municipal securities may, nevertheless, rise to the level of a recommendation for purposes of the Exchange Act and, therefore, records relating to such recommendation would be required to be maintained according to Rule 15Ba1-8(a)(4).

<sup>36</sup> See Rule G-42(d)(i)-(iii).

If a municipal advisor advises an MA Client that the third party's recommended municipal financial product or issuance of municipal securities is suitable and merely identifies one or more alternatives that the municipal advisor also believes are worth considering, the municipal advisor has not made a G-42 Recommendation because, in this example, the municipal advisor's advice was not a call to action for the MA Client to proceed with a specific municipal financial product or issuance of municipal securities. If, however, the municipal advisor determines that at least one option, such as following the third party's recommendation that the municipal advisor reviewed, is suitable, and advises the MA Client to proceed with the transaction the third party initially recommended over the other alternatives, then that advice would be a G-42 Recommendation.

## SCENARIOS ILLUSTRATING WHEN A MUNICIPAL ADVISOR DOES OR DOES NOT MAKE A RULE G-42 RECOMMENDATION<sup>37</sup>

### Scenario 1

A municipal advisor is hired to advise a city regarding the possible issuance of municipal securities. The city is struggling financially and has been for at least 15 years. During the prior five-year period, the city was advised by another municipal advisor and, based on the prior municipal advisor's advice, issued municipal securities three times. The city informs the current municipal advisor that the city is having difficulty servicing this debt. As part of its engagement, the municipal advisor reviews the city's financial management plan and prior issuances and informs the city that its prior decision to repay most of its outstanding debt over a 10-year period may not have been optimal. In its analysis, the municipal advisor also informs the city that one of the prior bonds issued is currently callable, interest rates remain low, and encourages the city to consider restructuring its debt to lengthen the stream of debt service payments to make debt service more manageable.

**Analysis:** The municipal advisor's advice is in response to the city's request for municipal advisory services, and although the communication is particularized to the specific needs, objectives or circumstances of the municipal entity and *relates* to the issuance of municipal securities, the statements do not include a call to action to the city

to proceed with a specific municipal securities issuance or municipal financial product. Accordingly, the advice does not rise to the level of a G-42 Recommendation. If the communication had also included affirmative statements to proceed with a specific issuance (e.g., "The city should restructure its debt in the manner set forth in the analysis provided."), the communication likely would have been a G-42 Recommendation. The advice is subject to duties and obligations under Rule G-42 generally, but does not trigger the additional duties and obligations, such as the obligation to make a suitability determination, that apply when a municipal advisor makes a G-42 Recommendation.

Although the advice is not a G-42 Recommendation, the duties and obligations under Rule G-42 require, among other things, the municipal advisor to act in the city's best interest without regard to the financial or other interests of the municipal advisor.

### Scenario 2

A municipal advisor is retained by a school district, which is a municipal entity, to advise the school district on all aspects of a new bond issuance. Shortly after being hired, an employee of the municipal advisor prepares a document that identifies past issuances of municipal securities offered by school districts of approximately the same size as the school district, located in the same state as the school district, and subject to the same restrictions and legal requirements. In addition, the basic terms of each issuance are summarized. At one of the initial meetings, the municipal advisor summarizes the terms of three of the offerings identified by the employee. The municipal advisor concludes her presentation to the school district, noting that in the current market, investors continue to accept the coupon and other terms as used in the prior three issuances, and she would expect the offering under discussion to provide similarly favorable results for the school district. In her closing remarks, the municipal advisor states, "I wanted to present this information to you today to obtain your preliminary reactions. I believe that the school district could comfortably move forward on similar terms based on my analysis of these comparable offerings, but I have not finished my review of all options and I'd like to meet again later to discuss my conclusions."

**Analysis:** Although the municipal advisor discussed one or more offerings and advised the MA Client of three

<sup>37</sup> Unless otherwise noted, the municipal advisor's communications used in the illustrations are assumed to meet the definition of "advice" for purposes of Section 15B of the Exchange Act and the rules and regulations thereunder and, therefore, are advice for purposes of Rule G-42.

The scenarios are meant to provide context for making determinations regarding whether advice is a G-42 Recommendation. The scenarios do not purport to delineate a bright-line test. In particular, the MSRB notes that a municipal advisor cannot avoid making a G-42 Recommendation merely by using a particular word (e.g., "could" or "may"), as such determination is based on the totality of the facts and circumstances of the particular situation.

offerings that may provide a model for the school district's next issuance, the municipal advisor did not recommend a specific municipal securities transaction. Accordingly, the advice did not rise to the level of a G-42 Recommendation. Consistent with the approach outlined in the [2002 Dealer Guidance](#), an important factor in determining whether a communication, even where it is advice, is also a G-42 Recommendation is whether the municipal advisor's communication to its MA Client could reasonably be viewed as a "call to action" to proceed with a specific municipal securities transaction or a specific municipal financial product. The advice described here was made about, and during, the preliminary stages of developing a plan to issue municipal securities for the school district. Moreover, the municipal advisor accompanied the advice with an explanation that she intended to begin a discussion and that she had not completed a review and would have definitive conclusions at a later date. As noted earlier, although all facts and circumstances surrounding any advice from a municipal advisor to the MA Client must be considered, advice by a municipal advisor to an MA Client that concerns preliminary matters, such as those described above, or minor or ancillary matters that relate to, but are not calls to action to proceed with a specific municipal securities issuance or a municipal financial product, are not G-42 Recommendations.

Note that even in the case of advice that falls short of being a G-42 Recommendation, a subsequent communication could, based on the content and context, constitute a G-42 Recommendation requiring a suitability analysis. Additionally, if the totality of the particular facts and circumstances indicates that the information addressed in the municipal advisor's previous advice is a basis for the G-42 Recommendation, then the prior information would be part of the suitability analysis. Also, note that because the client is a municipal entity, in addition to the obligations under Rule G-42(d), the municipal advisor's advice and recommendation must be in the client's best interest without regard to the municipal advisor's financial or other interests.

### Scenario 3

A municipal advisor has entered into a multi-year engagement with a city and periodically provides advice to the city. The city gives the municipal advisor a list of infrastructure improvements and new projects the city wants to undertake, which the city estimates will require \$40 million in financing to complete. The city asks the

municipal advisor for a recommendation on how to restructure its debt in five years in a manner that will allow the city to undertake the projects and not subject the city's residents to a property tax increase, or to limit a property tax increase to no more than \$50, on average, per homeowner. The municipal advisor presents a five-year plan to the city that includes a discussion of the city's requirements and concludes that to finance the projects having the highest priority and to stay within the mandate not to increase property taxes by more than \$50 per homeowner, only \$20 million bonds may be issued in the next five years. In context, the plan makes plainly evident the municipal advisor's view that the city should pursue the issuance of five municipal bond offerings during the five-year period, specifying when each issuance should occur, and for each municipal offering, the structure to be used, and other terms.

**Analysis:** The statements in the five-year plan regarding the five municipal bond offerings constitute G-42 Recommendations because the municipal advisor's statements were, as to each offering, a call to action regarding a specific municipal securities issuance. That is, in response to the city's request for a recommendation, the municipal advisor communicated to the city that it should make the issuances and described specific bonds for each issuance, including the structure to be used, when each bond should be issued and other terms. As noted above, the determination as to whether advice is a G-42 Recommendation is based on the total mix of the facts and circumstances and the inclusion or absence of a particular term, such as "could" or "may", will not, alone, be determinative of whether the communication is, or is not, a G-42 Recommendation. A G-42 Recommendation could be implied based on the facts and circumstances, including the context and content of information communicated to the MA Client. The use of a disclaimer that a communication to an MA Client is not, nor intended to be, a recommendation, while not dispositive, would be a factor in considering the totality of the facts and circumstances.<sup>38</sup>

### Scenario 4

The same municipal advisor described in Scenario 3 is called by the city 18 months after the city council approves the five-year plan with a schedule for five bond offerings. The municipal advisor is asked to assist with an additional financing that the city has determined must be concluded in the last quarter of the current year. The city also informs the municipal advisor that the city has determined the

<sup>38</sup> See e.g., the example set forth in Scenario 2, above.



structure and amount of the bond offering and will privately place the bond with a particular bank.<sup>39</sup> The municipal advisor agrees to assist with the issuance and agrees with the city to limit the scope of the engagement to matters that have not already been decided by the MA Client. The municipal advisor has several meetings with the city and, consistent with the scope of the engagement, provides advice regarding only certain aspects of the bond sale, such as how similar bonds have priced recently, but does not provide advice on matters that were previously decided by the city, such as the type of issuance (private placement), timing and amount of the issuance and identity of the investor (the bank).

**Analysis:** The advice provided by the municipal advisor, while regarding a specific issuance of municipal securities, was not a G-42 Recommendation. The municipal advisor's advice, consistent with the scope of the engagement, was limited and did not include a call to action to proceed with a specific municipal securities issuance or municipal financial product as the city was already proceeding with a specific issuance.

### Scenario 5

A municipal advisor has a multi-year engagement with a county and periodically provides advice to the county. The county board of supervisors is contemplating several projects and asks the municipal advisor to advise it of the impact on property taxes, if the county issued, in the next year, \$8 million, \$10 million or \$18 million in municipal securities. The municipal advisor makes the calculations and advises the county board of the approximate additional tax burden to the average resident of the county for each possible issuance amount.

**Analysis:** The municipal advisor's communication with the county board may be advice regarding the potential impact that issuing municipal securities of three different sizes may have on the county's taxpayers, but it is not a G-42 Recommendation. While the municipal advisor's advice is in connection with a possible future bond offering, the communication is not a G-42 Recommendation because the advice is not a call to action to proceed with a specific issuance of municipal securities.

Should the municipal advisor later advise the county board to proceed with the \$10 million issuance of municipal securities based on the tax burden analysis, the advice to proceed with a specific issuance would be a G-42 Recommendation. In addition, the municipal advisor's

obligation to make a suitability determination and undertake a reasonable investigation to determine that it is not basing any recommendation on materially inaccurate or incomplete information would include a review of the tax burden analysis because that earlier advice was embedded in the G-42 Recommendation as the basis for the call to action.<sup>40</sup>

### Scenario 6

A municipal advisor has a multi-year engagement with a county and periodically provides advice to the county. The county board is contemplating several projects and asks the municipal advisor to assist it in structuring a municipal securities offering that will allow the county to borrow \$30 million over 30 years. The municipal advisor presents a document to the county board detailing the structure and certain terms of a municipal securities offering that the municipal advisor believes the county should undertake. The communication was developed based on information about the county the municipal advisor obtained through its reasonable diligence, and includes a thorough profile of the county, conservative financial projections regarding revenues to be obtained from the completed projects and other information consistent with the municipal advisor's obligations under Rule G-42.

The county board votes to proceed with the offering. In subsequent meetings with the county board, the municipal advisor states to county officials that certain risks to investors should be clearly and thoroughly documented and discussed in the offering statement. The county board agrees and asks the municipal advisor to provide a summary insert for the offering statement that outlines the risks the municipal advisor brought to the county's attention. The municipal advisor's draft summary would be reviewed, supplemented and revised by underwriter's counsel prior to inclusion in the offering statement.

**Analysis:** In this case, the municipal advisor made a G-42 Recommendation of an offering of municipal securities when, in response to the county board's request, the municipal advisor presented the document to the county board detailing the structure and certain terms of an offering of municipal securities that the municipal advisor believed was in the best interests of the county. The municipal advisor's subsequent communication to the county board that certain risks should be clearly and thoroughly documented in the official statement is not considered a G-42 Recommendation.

<sup>39</sup> Assume, for purposes of this scenario, that the private placement to the bank involves a "security" as defined in Section 3(a)(10) of the Exchange Act.

<sup>40</sup> See e.g., Rule G-42, Supplementary Material .01, Duty of Care.

## ADDITIONAL RESOURCES

Documents that may also be helpful to review include:

- [SR-MSRB-2015-03 - MSRB Proposed Rule Change to Adopt New Rule G-42](#) (April 24, 2015)
- [MSRB Response to Comments on SR-MSRB-2015-03](#) (August 12, 2015)
- [MSRB Response to Comments on SR-MSRB-2015-03](#) (December 16, 2015)
- [Securities and Exchange Commission \(SEC\) Final Municipal Advisor Registration Rule](#) (see *discussion regarding advice*)
- [SEC FAQs on Registration of Municipal Advisors](#) (updated September 20, 2017)