# Municipal Bonds (Fixed Income):
# Important Disclosures for D.A. Davidson & Co. Clients

D.A. Davidson & Co. member SIPC

The following is important information regarding investments in municipal bonds (sometimes referred to as "muni bonds" or "munis"), including information about the compensation that D.A. Davidson & Co. ("D.A. Davidson") and our financial professionals (together, "we," "us" or "our") receive for buying and selling municipal bonds, and the conflicts of interest those payments create.

If you have any questions about any of the topics discussed below, or municipal bond investing generally, we encourage you to reach out to your D.A. Davidson financial professional.

## Overview of Municipal Bonds

Municipal bonds are fixed-income (debt) investments that are issued by state and local government entities to finance public works and other projects. Like any other bond, when you purchase a municipal bond, you are lending the investment proceeds to the issuer. In exchange, the issuer promises to pay a stated rate of interest, sometimes called the "coupon rate," until the end of the bond's life (the "maturity"). At maturity, the issuer also promises to return your money invested (your principal). For municipal bonds, interest payments are usually made semi-annually.

Some municipal bonds – referred to as "callable" bonds - allow the issuer to redeem (repay) the bond prior to maturity, and avoid making subsequent interest payments. Other municipal bonds are redeemable by the issuer prior to maturity upon the occurrence of certain events as enumerated in the offering document or prospectus.

Municipal bonds have varying levels of Credit Risk (in other words, the risk that the government issuer will default on its obligations), which depend on a number of factors. Generally, there are two overall types of municipal bonds:

- **General Obligation Bonds.** The issuer's obligation to pay principal and interest due to bondholders is usually secured by the "full faith and credit"* of the government issuer, which in turn is often (but not always) supported by the issuer's taxing power.

  **Please note that all general obligation bonds have at least some Credit Risk. They should not be confused with Treasury bonds and similar instruments that are backed by the "full faith and credit" of the U.S. Government, which are generally considered to have no Credit Risk.**

- **Revenue Bonds.** The issuer's obligation to pay principal and interest due to bondholders is supported just by the revenues derived from the public works or other project specified in the bond issue (for example, tolls from a road, revenues collected by a public utility or hospital, etc.), and not by the full faith and credit of the government issuer. Some revenue bonds, called "conduit" bonds, are issued to benefit a charity, hospital, university or other entity, which borrows the funds generated by the bonds from the issuing government. The issuer is usually not responsible if required payments to bondholders on "conduit" revenue bonds are not made. More broadly, if any revenue bond is a "non-recourse" bond and payments are not made when due, bondholders do not have a claim against the issuer, or the underlying project or its revenue stream.

For many municipal bonds, interest payments are exempt from federal income taxation.** Some municipal bonds are also exempt from state income taxation, at least in some cases. Tax-exempt municipal bonds generally pay lower coupon rates than other bonds with similar credit quality, because they offer investors this additional tax advantage. For these reasons, tax-exempt municipal bonds are generally more appropriate for investors in higher tax brackets – that is, for whom reduction of taxable income is a goal that might justify somewhat lower interest payments. For the same reason, it is generally inadvisable to invest in tax-exempt municipal bonds through an IRA, 401(k) plan or other tax-exempt vehicle.

****Please note that not all municipal bonds qualify for the federal tax exemption.**

Municipal bonds – like all bond investing - can be complicated. However, there are a few basic principles you should understand. Generally speaking:

- **Credit Quality and Coupon (Interest) Rate.** There is an inverse relationship between the creditworthiness of a bond's issuer (called the "credit quality" of the bond) and its coupon rate. Less creditworthy borrowers – regarded as more likely to default on their obligations – will have to pay higher rates to compensate investors for the increased Credit Risk (risk of default). More creditworthy issuers will be able to pay less interest and still sell their bonds.

- **Interest Rates and Bond Prices.** There is also an inverse relationship between market interest rates and the prices of existing bonds. If interest rates go down, a bond with a (higher) coupon rate will be more valuable by comparison to newly-issued bonds. If interest rates increase, a bond with a (lower) coupon rate will be less valuable by comparison - this is referred to as “Interest Rate Risk.”

- **Maturity and Coupon Rate.** In most cases, there is a direct relationship between a bond’s maturity and its coupon rate. Because Interest Rate Risk is higher over long periods, longer-term bonds will usually have to pay higher rates to compensate investors.

If your D.A. Davidson financial professional recommends municipal bonds for your account, he or she will discuss the specifics of the recommended bonds with you, including material risks.

## Municipal Bonds – Our Compensation and Conflicts of Interest

***Municipal Bonds in Brokerage Accounts.*** The compensation we receive for buying and selling municipal bonds on your behalf depends on the specific circumstances.

*Primary Market.* In some cases, D.A. Davidson acts as an underwriter (in other words, a distributor) of municipal bonds, meaning we sell newly-issued municipal bonds to investors on the “primary” market. In those cases, we receive underwriting, syndicate and other similar fees for our services from the municipal bond’s issuer. These sales are “principal” trades, because we are effectively selling municipal bonds to you from our own inventory. Certain bonds traded on the primary market are not traded principally in our ERISA and IRA accounts. Typically, the sale of newly issued bonds will compensate your financial professional and the Firm more than the sale of bonds on the secondary market.

For municipal bonds underwritten by D.A. Davidson and other primary market sales, the compensation D.A. Davidson would receive is usually “paid” to our Firm as an underwriting discount, which is similar to a mark-up (see below), and (expressed as a percentage of the purchase price you pay) would typically be between 0.35% and 2.0%. A portion of this compensation (typically 20-30%) is taken into account when determining your financial professional’s compensation for selling you the municipal bonds. The remainder of the underwriting discount compensates other employees of the Firm for their role in the underwriting and distribution process.

If your D.A. Davidson financial professional recommends an investment in a municipal bond for which we are the underwriter, or any other primary market trade, he or she will refer you to the offering document for the municipal bond, which contains detailed information about the compensation we would receive.

*Secondary Market.* On the secondary market, we can also buy or sell existing municipal bonds on your behalf as your agent (broker), where the other party to the trade is a third-party investor. In addition, in some cases we may buy previously-issued municipal bonds for D.A. Davidson’s inventory from you, or sell them from our inventory to you, on the secondary market (which are principal trades). Municipal bonds traded on the secondary market are not traded principally in our ERISA and IRA accounts.

For secondary market purchases or sales of municipal bonds, D.A. Davidson charges “mark-ups” (adjustments from the prevailing market price) when municipal bonds are purchased, and “mark-downs” when municipal bonds are sold, within your brokerage account. Mark-ups and mark-downs are generally equivalent to brokerage commissions, meaning they are adjusted from the transaction proceeds and are imposed one-time for each purchase or sale, as applicable. A percentage of those mark-ups and mark-downs are paid by D.A. Davidson to your financial professional, according to his or her “production” and our commission grid.

The maximum mark-ups and mark-downs we charge on secondary market purchases and sales of municipal bonds are determined according to maturity, as set forth in the following table. These rates were set to align with fixed income product pricing, where longer maturities generally result in more income to the holder. Note that your mark-up or mark-down may also be lower than the maximum noted below due to discounting or the market price, among other factors. Please also note that these rates are current as of the effective date set forth on the last page of this disclosure, and D.A Davidson reserves the right to change these mark-up and mark-down rates at any time.

**Fixed Income Pricing for “secondary market” (previously-issued) municipal bond transactions:**

| Maturity | Maximum Mark-Up on Purchase |
|---|---|
| Less than one (1) year | 0.250% |
| 1-2 years | 1.125% |
| 3-5 years | 1.875% |
| 6-14 years | 2.250% |
| 15 years & longer | 2.500% |

| Maturity | Maximum Mark-Down on Sale |
|---|---|
| Less than one (1) year | 0.250% |
| 1-2 years | 0.625% |
| 3-5 years | 0.875% |
| 6 years & longer | 1.000% |

**These payments (underwriting and similar fees, mark-ups and mark-downs) create conflicts of interest for us**. In particular:

- **Principal Trades of Municipal Bonds.** Generally, we receive more total compensation and other benefits for principal trades of municipal bonds than we receive for non-principal trades. This create an incentive for us to recommend municipal bonds that we trade on a principal basis.

- **Underwriting Compensation.** When we act as an underwriter, we take on the risk of distribution, meaning we may lose money if our distribution efforts fail. In cases where we underwrite and distribute new municipal bond issuances on the primary market, we receive underwriting fees, syndicate fees and similar forms of compensation for our consulting and distribution services. These payments create an incentive for us to recommend bonds we underwrite over other investments.

- **Volume of Municipal Bond Trades***.* We receive compensation for each purchase or sale of municipal bonds that occurs in your brokerage account. This creates an incentive for us to recommend that you trade frequently.

- **Differential Compensation - Municipal Bonds vs. Other Investments***.* The compensation we receive for buying and selling municipal bonds on your behalf (or to/from you), will be more or less than we would receive for buying and selling different investments, such as stocks, mutual funds or other products. This creates an incentive for us to recommend investments that pay us more compensation over those that pay us less compensation, or no compensation.

To help manage the conflict related to engaging in principal trades of municipal bonds our financial professionals cannot request a specific trade process and are not compensated solely based on whether the trade is entered on a principal or agency basis.

To help manage the conflict related to additional underwriting compensation we have a supervisory process for reviewing certain criteria around primary market transactions to ensure they align with a client's investment profile. In the event that your D.A. Davidson financial professional recommends a primary market trade for your account, he or she will discuss this with you, and provide you with specific information about the compensation we would receive.

To help manage the conflicts related to the volume of trading, D.A. Davidson has policies and procedures in place that prohibit our financial professionals from recommending a volume of trading (as to frequency, amount or both) that is excessive under the circumstances, as well as systems to help identify situations where this could be occurring. Recommending excessive trading volume in order to increase brokerage commissions is an abusive practice sometimes referred to as "churning."

To help manage the conflicts related to recommending municipal bonds over certain other investments that trade in the same manner we charge the same maximum mark-ups and mark-downs for these types of bonds as for Treasuries, TIPS, and all other types of fixed-income investments, such as CDs. For secondary market trades, we also charge the same maximum mark-ups and mark-downs for municipal bonds as for all other types of bonds. Our Firm also provides resources and training to encourage our financial professionals to consider comparable products available on our platform and the appropriateness of each product based on the client's investment profile.

In short, there are conflicts between our interests and those of our brokerage clients relating to municipal bond investments (and the other investments we make available to our brokerage clients). The policies summarized above are intended to help mitigate those conflicts.

***Municipal Bonds in Advisory Accounts.*** Neither D.A. Davidson nor our financial professionals receive any mark-ups or mark-downs on secondary market purchases or sales of municipal bonds through our wrap fee programs or other investment advisory accounts (accounts in which the client pays an asset-based fee, as opposed to commissions and other amounts that apply to each transaction). The value of municipal bonds in an advisory account, like the value of other securities held in the account, is included in determining the asset-based fee.

**If you have questions about the compensation D.A. Davidson or your D.A. Davidson financial professional receives from the sale or purchase of municipal bonds, please contact your D.A. Davidson financial**

**professional.**

## Municipal Bonds – Primary Risks

Municipal bonds, like virtually all investments, carry certain risks. The risks associated with a particular municipal bond will depend on a number of factors, including the creditworthiness of its issuer, the underlying project, whether it is a general obligation bond or revenue bond, and a number of other variables. Because there are many differences between municipal bonds and municipal bond issuers, the potential categories of primary risks are broad. **Therefore, this discussion is not comprehensive, and we strongly encourage you to discuss the risks associated with municipal bond investments with your D.A. Davidson financial professional.**

However, below are some examples of the most material risks associated with (i) municipal bond investing generally, and (ii) investments in certain municipal bonds:

**Risks of Municipal Bond Investments Generally:**

- **Credit Risk (or Default Risk)** is the risk that issuer or guarantor of a fixed-income security will be unwilling or unable to meet its obligations to pay interest and/or principal when due, for example due to the issuer's bankruptcy or insolvency. Changes in the credit rating of fixed-income securities could have a similar effect.

- **Interest Rate Risk** is the risk that the value of fixed-income investments will decline because of rising interest rates. The magnitude of this decline will often be greater for longer-term fixed-income securities than shorter-term fixed-income securities.

- **Real Interest Rate Risk (or Inflation Risk)** is the risk that the real rate of return paid on fixed-income investments will be less than the nominal return due to the effect of inflation.

- **Reinvestment Risk** is the risk that, in a declining interest rate environment, investors holding fixed-income investments may have to reinvest proceeds in other investments that do not pay comparable levels of income to those of the redeemed or called investments. This can lead either to a reduction in cash flows or the need to reinvest in investments having a higher Credit (Default) Risk.

**Risks of Municipal Bond Investments – Selling Municipal Bonds on the Secondary Market:**

- **Liquidity Risk** is the risk that certain investments will not be sufficiently marketable to be sold (liquidated) within a short time frame without incurring a loss in value.

**Risks of High-Yield ("Below Investment Grade" or "Junk") Municipal Bonds:**

- **High-Yield Risk** is the risk that non-investment grade fixed-income securities, sometimes known as "junk bonds," have greater Credit Risk, price volatility and risk of loss than investment grade securities, which can adversely impact returns and asset valuation. High yield securities are considered primarily speculative with respect to the issuer's continuing ability to make principal and interest payments.

**Risks of Municipal Bond Investments – Callable or Redeemable Municipal Bonds:**

- **Prepayment Risk (or Call Risk)** is the risk that the issuer of fixed-income investments will exercise its right to prepay its obligations prior to maturity, which can result in a decreased rate of return and a decline in value of those investments.

- **Redeemable Bond Risk** is the risk that the issuer of fixed-income investments will redeem the bond upon the occurrence of certain enumerated events prior to maturity, which can result in a decreased rate of return and a decline in value of those investments.

**If you have any further questions, please do not hesitate to ask your D.A. Davidson financial professional. More information about investing in municipal bonds, which we encourage you to read, is available from the U.S. Securities and Exchange Commission (SEC) at investor.gov.**

**Additionally, access to municipal securities data and offering documents and educational information about municipal securities is available on the Municipal Securities Rulemaking Board's (MSRB) Electronic Municipal Market Access (EMMA) website at emma.msrb.org.**

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