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Category

Fair Practice

Affected Rules

[Rule G-8](#); [Rule G-9](#);
[Rule G-20](#)

Request for Comment on Draft Amendments to MSRB Rule G-20, on Gifts, Gratuities and Non-Cash Compensation, to Extend its Provisions to Municipal Advisors

Overview

The Municipal Securities Rulemaking Board (MSRB) is seeking comment on draft amendments to MSRB Rule G-20, on gifts, gratuities and non-cash compensation given or permitted to be given by brokers, dealers and municipal securities dealers (“dealers”). The draft amendments are designed to apply Rule G-20 and the related record keeping requirements of MSRB Rules G-8 and G-9 to municipal advisors. Also, as part of the MSRB’s broad initiative to streamline its rulebook and codify interpretive guidance into MSRB rules, the draft amendments would incorporate various relevant interpretive guidance. Additionally, the draft amendments would add a new provision to explicitly prohibit MSRB regulated entities from expensing certain entertainment costs to municipal securities issuances.

Comments should be submitted no later than December 8, 2014, and may be submitted in electronic or paper form. Comments may be submitted electronically by clicking [here](#). Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314. All comments will be available for public inspection on the MSRB’s website.¹

Questions about this notice should be directed to Michael L. Post, Deputy General Counsel, Sharon Zackula, Associate General Counsel, or Benjamin A. Tecmire, Counsel, at 703-797-6600.

¹ Comments are posted on the MSRB website without change. Personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.



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Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) amended Section 15B of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”) to provide for the regulation by the Securities and Exchange Commission (SEC) and the MSRB of municipal advisors and to grant the MSRB certain authority to protect municipal entities and obligated persons.² The Dodd-Frank Act establishes a federal regulatory regime that requires municipal advisors to register with the SEC and prohibits them from engaging in any fraudulent, deceptive, or manipulative act or practice.³

The relevant legislative history of the Dodd-Frank Act indicates Congress was concerned with the previously unregulated conduct of municipal advisors and concluded that the MSRB should be the self-regulatory organization designated to adopt a regulatory framework to regulate such conduct.⁴ The SEC subsequently reaffirmed that the regulation of municipal advisors and their advisory activities is intended to address problems observed in their previously unregulated conduct, which the SEC identified as including undisclosed conflicts of interest, advice rendered by financial advisors without adequate training or qualifications, and the failure of certain municipal advisors to put the duty of loyalty to their municipal entity clients ahead of their own interests.⁵

Existing Rules G-20, G-8 and G-9

Rule G-20 addresses a particular area of potential conflict of interest. The rule prohibits a dealer from giving directly or indirectly any thing or service of value, including gratuities, in excess of \$100 per year to a person (other than an employee of the dealer), if such payments or services are in relation to the municipal securities activities of the employer of the recipient (the “\$100 limit”). The \$100 limit does not apply to gifts considered to be “normal business dealings,” which include: (a) “reminder advertising”; (b) entertainment (*e.g.*, gifts of meals, sports tickets and other tickets) hosted by

² Pub. Law No. 111-203, 124 Stat. 1376 (2010) (the “Dodd-Frank Act”).

³ See Section 15B(a)(1)(B) and (a)(5) of the Exchange Act.

⁴ S. Report 111-176, at 38 (2010) (“[Senate Report](#)”).

⁵ Exchange Act Release No. 70462 (Sept. 20, 2013), 78 FR 67468 (Nov. 12, 2013) at 67469 (“MA Registration Adopting Release”); see *id.* at 67475 nn.104-6 and accompanying text (discussing relevant enforcement actions) (<http://www.sec.gov/rules/final/2013/34-70462.pdf>). See also, MSRB Notice 2014-01 (Jan. 9, 2014), Request for Comment on Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors, for more information about the Dodd-Frank Act and the MSRB’s development of a municipal advisor regulatory regime.

the dealer (*i.e.*, attended by the dealer or its associated person); and (c) the costs of sponsored legitimate business functions. The “normal business dealings” exclusion applies, however, only if such gifts are “not so frequent or so extensive as to raise any question of propriety.”

The \$100 limit also does not apply to contracts of employment or compensation for services rendered by a person employed by another, if there is a prior written agreement that includes the consent of the employer of such person, nature of the services and amount of compensation. Finally, the \$100 limit does not apply to the payment or receipt of non-cash compensation in connection with the sale and distribution of a primary offering (“non-cash compensation provision”), subject to certain conditions described in Rule G-20.

Rule G-20 Interpretive Guidance

Over the course of several years, the MSRB has adopted various interpretive guidance under Rule G-20, primarily addressing gifts that are not subject to the \$100 limit. A 2007 MSRB interpretive notice states that interpretive guidance published by the National Association of Securities Dealers (“NASD”) (now Financial Industry Regulatory Authority or “FINRA”) to assist dealers in complying with NASD Rule 3060 (now FINRA Rule 3220) regarding gifts also applies to comparable provisions of MSRB Rule G-20 (the “2007 Notice”).⁶ The 2007 Notice specifically refers to NASD Notice 06-69, which provides interpretive guidance with respect to the exclusion of personal gifts; gifts of de minimus value and promotional items; the valuation of gifts; and the aggregation of the value of gifts.⁷

In addition, FINRA has published an interpretive letter providing guidance on bereavement gifts, which has not been adopted by the MSRB.⁸

Existing Rules G-8 and G-9

Existing Rules G-8 and G-9 require dealers to make and retain certain records relating to their Rule G-20 obligations. These requirements include making and retaining records of all gifts and gratuities that are subject to the \$100 limit; all agreements of employment or for compensation for services

⁶ Rule G-20 Interpretive Notice, [Dealer Payments in Connection with the Municipal Securities Issuance Process](#) (Jan. 29, 2007) (“2007 Notice”).

⁷ NASD Notice 06-69 (Dec. 2006) (<http://www.finra.org/Industry/Regulation/Notices/2006/P018023>).

⁸ See FINRA Letter to Amal Aly, SIFMA (Reasonable and Customary Bereavement Gifts), dated December 17, 2007 (<https://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P037695>).

rendered; and all non-cash compensation in connection with the sale and distribution of a primary offering as described in Rule G-20.

Summary of Draft Amendments to Rules G-20, G-8 and G-9

The draft amendments to Rule G-20 would, generally: (i) extend the rule's existing provisions relating to gifts and gratuities and non-cash compensation to municipal advisors and their associated persons; (ii) streamline and codify applicable interpretive guidance; and (iii) explicitly prohibit the seeking or obtaining of reimbursement by a regulated entity of certain entertainment expenses from the proceeds of an offering of municipal securities. In addition, several other clarifying, non substantive, amendments have been made to improve the rule's readability and aid regulatory entities in complying with the rule's requirements.

Rule G-20, as amended, generally would apply the same policies embodied in the current rule (already applicable to dealers) to municipal advisors and their associated persons, including:

- the prohibition of gifts or gratuities in excess of \$100 per person per year in relation to the municipal securities activities of the recipient's employer;
- the exclusion from the \$100 limit of "normal business dealings"; and
- the exclusion from the \$100 limit of contracts of employment and contracts for compensation for services.

The concept of "reminder advertising" would be deleted from the "normal business dealings" exclusion under current paragraph (b). This amendment would clarify the types of gifts in the nature of reminder advertising that would be excluded from the \$100 limit (*e.g.*, transaction-commemorating, de minimis or promotional gifts). These changes would conform draft amended paragraph (d) with current FINRA interpretive guidance that the MSRB has previously stated applies to Rule G-20. The draft amendments would also make the \$100 limit applicable to gifts given in relation to the municipal advisory activities of the employer of the recipient. Currently, Rule G-20 only applies to gifts given in relation to the municipal *securities* activities of an employer of a recipient.

MSRB and FINRA Interpretive Guidance

The draft amendments would streamline and codify FINRA interpretive guidance previously adopted by the MSRB and incorporate additional relevant FINRA interpretive guidance that has not previously been adopted by the MSRB. The interpretive guidance codified by the draft amendments

would clarify that certain gifts and gratuities generally would not be subject to the \$100 limit, including: transaction-commemorating, de minimis, promotional, bereavement and personal gifts. These draft amendments would apply to all regulated entities and their associated persons.

Codifying currently applicable interpretive guidance and grouping the provisions in one paragraph of the draft amendments would make the rule easier to comply with and implement. The draft codification should also increase awareness among market participants of the terms of currently applicable interpretive guidance which may in turn promote compliance.

Interpretive guidance regarding gifts that would be superseded or made redundant because such guidance would be codified in rule text would be deleted as part of the draft amendments. Other MSRB guidance, and portions of applicable FINRA interpretive guidance that are not codified by the draft amendments, would continue to be applicable to the comparable provisions of Rule G-20.⁹ Any interpretive guidance deleted as result of the draft amendments would be archived and accessible on the MSRB website.

Personal Gifts

Draft paragraph .01 of the Supplementary Material to Rule G-20 would clarify the treatment of personal gifts under draft paragraphs (c) and (d). Paragraph .01 would also state that a number of factors would be considered when determining whether a gift is in relation to the municipal securities or municipal advisory activities of the employer of the recipient, including but not limited to the nature of any pre-existing personal or family relationship between the associated person giving the gift and the recipient, and whether the associated person or the regulated entity with which he or she is associated paid for the gift.

Applicability of Other Laws and Regulations

Draft paragraph .02 of the Supplementary Material to Rule G-20 would clarify that, in addition to the requirements of Rule G-20, regulated entities may also be subject “to other duties, restrictions or obligations under state or other laws” and that amended Rule G-20 would not supersede any more

⁹ For example, FINRA interpretive guidance currently requires firms to aggregate all gifts given by FINRA members (and each associated person of the FINRA member) to a particular recipient over the course of a year and to state in their procedures whether the member is aggregating gifts on a “calendar year, fiscal year, or on a rolling basis beginning with the first gift to any particular recipient.” Also, it requires FINRA members to value gifts at the higher of cost or face value. FINRA guidance also states that when giving gifts to multiple recipients, firms should “record the names of each recipient and calculate and record the value of the gift on a pro rata per recipient basis, for purposes of ensuring compliance with the \$100 limit.” See *supra* at n. 7.

restrictive provisions of state or other laws applicable to regulated entities or their associated persons. As newly regulated persons and entities, the provision would serve to caution municipal advisors that various laws and regulations may apply in addition to MSRB rules.

Additional Standard Regarding Frequency and Extensiveness of Gifts

Draft amended paragraph (d) would add the requirement that gifts not subject to the \$100 limit (*e.g.*, normal business dealings, de minimis or promotional gifts) must not be “so frequent or so extensive as to raise any question of propriety or to give rise to any apparent or actual material conflict of interest.” The application of the first component of this standard, pertaining to the raising of questions of propriety, would conform to the MSRB’s and FINRA’s current treatment of normal business dealings and the same categories of gifts. The addition of the second component regarding material conflicts of interest is consistent with the MSRB’s 2007 Notice, which encourages adherence to the highest ethical standards and states that Rule G-20 was designed to “avoid conflicts of interest.”¹⁰

Prohibition of Reimbursement for Entertainment Expenses

Draft paragraph (e) of Rule G-20 would prohibit regulated entities from requesting or obtaining reimbursement for entertainment expenses from the proceeds of an offering of municipal securities. This provision would address a regulatory gap highlighted by a recent FINRA enforcement action.¹¹ Specifically, the draft provision would provide that a regulated entity engaging in municipal securities or municipal advisory activities with a municipal entity is prohibited from requesting or obtaining reimbursement for expenses related to the entertainment of any person from the proceeds of the offering of such municipal securities.

The term “entertainment expenses,” as used in the draft amended rule, would not include “reasonable and necessary expenses for meals hosted by the regulated entity and directly related to the offering for which the regulated entity was retained.” The draft amendment would also not restrict the generally accepted market practice of a regulated entity advancing normal travel costs (*e.g.*, reasonable airfare and hotel accommodations) to an official or other personnel of a municipal entity for business travel related

¹⁰ See *supra* at n. 6.

¹¹ *Department of Enforcement v. Gardnyr Michael Capital, Inc. (CRD No. 30520) and Pfilip Gardnyr Hunt, Jr.*, FINRA Disciplinary Proceeding No. 2011026664301 (Jan. 28, 2014) (concluding that while the hearing panel did not “endorse the practice of municipal securities firms seeking and obtaining reimbursement for entertainment expenses incurred in bond rating trips,” neither the MSRB’s rules nor interpretive guidance put the dealer on fair notice that such conduct would be unlawful).

to a municipal securities issuance, such as bond rating trips, and obtaining reimbursement for such costs. Examples of prohibited entertainment expenses would, for purposes of draft provision (e), include tickets to theater, sporting or other recreational spectator events, sightseeing tours and transportation related to attending entertainment events.

Recordkeeping Requirements for Municipal Advisors

Rules G-8 and G-9 would be amended to establish the same record keeping requirements related to Rule G-20 for municipal advisors that currently apply to dealers. As with dealers, municipal advisors would be required to make and retain records of all gifts and gratuities that are subject to the \$100 limit, all agreements of employment or for compensation for services rendered, and all non-cash compensation in connection with the sale and distribution of a primary offering as described in Rule G-20.

New Defined Terms

Lastly, the draft amendments to Rule G-20 would include two new defined terms – regulated entity and person. “Regulated entity” would mean all brokers, dealers, municipal securities dealers and municipal advisors for purposes of Rule G-20. Associated persons would not be included in this new defined term. Incorporation of this term would simplify and shorten the text of the rule. “Person” would mean a natural person and codify the MSRB’s existing interpretive guidance stating the same.¹²

Economic Analysis

The Board has historically given careful consideration to the costs and benefits of its new and amended rules. The Board recently adopted a policy to more formally integrate economic analysis into its rulemaking process. The policy, while in transition, can be used to guide consideration of the draft amendments. According to the policy, prior to proceeding with a rulemaking, the Board should evaluate the need for the potential rule change and determine whether the rule change as drafted, will, in its judgment, meet that need. During the same timeframe, the Board also should identify the data and other information it would need in order to make an informed judgment about the potential economic consequences of the rule change, make a preliminary identification of relevant baselines and reasonable alternatives to the rule change, and consider the potential benefits and costs of the rule change and the main alternative regulatory approaches.

¹² See [MSRB Interpretive Letter “Person” \(Mar. 19, 1980\)](#).

1. The need for the draft amendments to Rule G-20 and how the draft amendments will meet that need.

The need for the draft amendments to Rule G-20 arises primarily from the Dodd-Frank Act. As previously discussed, the Dodd-Frank Act expanded the MSRB's regulatory authority to include the oversight of and certain regulatory authority over, municipal advisors.¹³ In furtherance of the mandates and purposes of the Dodd-Frank Act, the draft amendments would seek to address potential undisclosed conflicts of interest, the potential failure of municipal advisors to place the duty of loyalty to clients that are municipal entities above their own interests, and other related issues. These issues, if left unaddressed, could adversely affect the integrity of the municipal securities market, increase costs borne by issuers and investors, and negatively affect investor and public confidence.

The draft amendments would also address and minimize the improper influence, or the appearance of improper influence, exerted by some municipal advisors. Extending the current gift and non-cash compensation prohibitions to municipal advisors and their municipal advisory activities would curb or limit the receipt of gifts and non-cash compensation by such persons and thereby reduce the risk that the selection or retention of a municipal advisor would be based on improper, non-meritorious factors. Rather, the draft amendments would aim to encourage the selection of municipal advisors on their merits (*e.g.*, the quality of advice, level of expertise and services offered by the municipal advisor), availability and ability to provide such services at a price competitive with the pricing of comparable municipal advisors.

In addition, the draft amendments are necessary to reduce the occurrence of instances in which the cost of issuance or related advice may increase because municipal advisors are selected or are perceived to be selected on the basis of non-meritorious factors, or provide services in a relationship in which they exercise undue influence or as to which there are conflicts of interest. When non-meritorious factors affect the selection or retention of a municipal advisor, a variety of increased costs may be borne by the municipal entity related to the specific municipal advisory services provided. These unwarranted costs may include uncompetitive market rates for advisory services; disproportionately high costs for the services obtained relative to the quality of services provided by the municipal advisor; or the costs of receiving and acting upon advice from an unqualified, or under-qualified, municipal advisor. Also, there may be other extraordinary costs, including

¹³ See Section 15B(a)(1)(B), (a)(5) and (b)(2) of the Exchange Act.

additional costs incurred because an unqualified or under-qualified municipal advisor requires a longer period of time to complete its assigned tasks. Moreover, in any scenario in which a regulated entity makes or is perceived to make decisions subject to undue influence or influenced by conflicts of interest, investors may question the qualifications of regulated entities retained to provide services, the integrity of the municipal entity and any specific issuance, and more broadly, the integrity of the municipal securities market. The loss of investor confidence may result in costs that will be borne by the municipal entity, including potentially, a higher cost of capital, other municipal entities, and investors in the municipal securities issued by those municipal entities.¹⁴

The draft amendments would also address the need to develop a regulatory regime that applies to regulated entities in a consistent and congruent manner. Currently, Rule G-20 does not apply to municipal advisors (that are not also dealers or associated persons of a dealer) nor does it cover gift giving in relation to municipal advisory activities. The draft amendments would achieve an important goal of harmonizing regulatory requirements that apply to persons operating in the same market to the extent possible, in order to enhance efficiencies and reduce costs, including the costs of compliance, and reduce the complexity of the regulatory framework, when appropriate. In addition, harmonization would create a more level playing field. Conversely, without these amendments to Rule G-20, dealer/municipal advisors could be at a competitive disadvantage compared with non-dealer municipal advisors.

The draft amendments' prohibition against the use of offering proceeds to pay certain entertainment expenses is a new provision that would apply to all regulated entities. The impetus for this amendment arises because certain regulated entities have requested or obtained reimbursement from the proceeds of an offering of municipal securities for costs and expenses for entertainment and meals that were not necessary or related to the offering of the municipal securities. The draft amendments would clarify that such conduct is inconsistent with just and equitable principles of trade.

Finally, the draft amendments are needed to curb undue influence and conflicts of interest that may arise related to this practice. The act of providing to employees of a municipal entity entertainment or certain meals, (even though the expenses of such gratuities are later reimbursed as part of offering expenses) may result in improper influence and give rise to conflicts

¹⁴ Under Section 15B(b)(2)(C) of the Exchange Act, the MSRB is charged by Congress to adopt rules to "remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products."

of interest. As noted above, regulated entities compete with each other in several ways, including through the quality of services offered and the pricing of those services. If a dealer or a municipal advisor is selected because the dealer or municipal advisor routinely provides, for example, expensive sporting tickets or unnecessarily extravagant meals to employees or agents of a municipal entity during an underwriting, such gratuities may form the basis for their selection as dealer or municipal advisor to the municipal entity rather than the dealer's or municipal advisor's qualifications and competitive pricing. There is also a greater risk that the dealer or municipal advisor may be less qualified to provide services of the scope and quality sought by the municipal entity compared to other dealers or municipal advisors, or may provide such services at a higher cost including the costs associated with the giving of gifts and gratuities.

2. Relevant baselines against which the likely economic impact of elements of the draft amendments to Rule G-20 can be measured.

To evaluate the potential impact of the draft amendments' requirements, a baseline, or baselines, must be established as a point of reference. The analysis proceeds by comparing the expected state with the draft amendments to Rule G-20 in effect to the baseline state prior to the draft amendments taking effect. The economic impact of the draft amendments is measured as the difference between these two states.

With respect to the draft amendments, different baselines will apply depending on the business activities of each regulated entity.

For dealers that are not also engaged in municipal advisory activities, the baseline is the current Rule G-20 and the set of existing MSRB interpretations. For these entities, the draft amendments are substantially similar to the baseline Rule G-20 requirements with the exception of the new provision that prohibits the use of proceeds of an offering of municipal securities to reimburse costs and expenses related to certain entertainment provided.

For brokers, dealers, or municipal securities dealers that are also municipal advisors ("dealer/MAs"), the baseline will depend on whether and to what extent existing municipal advisory services constituted financial advisory services prior to the passage of the Dodd-Frank Act. Financial advisory services that were reclassified as municipal advisory services were governed by Rule G-20. As such the baseline for these activities is the current Rule G-20 and the set of existing MSRB interpretations. As already noted, the draft amendments are substantially similar to these baseline Rule G-20

requirements with the exception of the provision prohibiting the use of proceeds of an offering of municipal securities to reimburse costs and expenses related to certain entertainment provided.

A baseline for dealer/MAs offering any municipal advisory services that did not constitute financial advisory services and for municipal advisors that are not also dealers is the Dodd-Frank Act itself, which subjects municipal advisors to regulation by the MSRB. As discussed previously, the Dodd-Frank Act contemplated a regulatory regime for municipal advisors and municipal advisory activities that would be comparable to the regulatory regimes applicable to other participants in the securities markets. Dealer/MAs in this category, however, may have relevant Rule G-20 experience to draw upon as the scope of covered business activities of the employer of a gift recipient is extended to include the gifts in relation to an employer's municipal advisory activities.

An additional baseline applies to municipal advisors who are also registered as investment advisors and subject to the requirements of the Investment Advisers Act of 1940 ("municipal advisors/investment advisors"). Under SEC Rule 204A-1, an investment adviser must establish, maintain and enforce a code of ethics. The code of ethics must include standards of business conduct that the investment adviser requires of its supervised persons, and such standards must reflect the investment adviser's fiduciary obligations and those of the investment adviser's supervised persons.¹⁵ Such standards may include certain topics, such as gifts, although SEC Rule 204A-1 does not specifically refer to gifts. SEC Rule 204A-1 also requires that any violation of a standard be reported promptly to the firm's chief compliance officer.¹⁶ SEC Rule 204A-1 serves as a baseline to the extent it requires municipal advisors/investment advisors to have developed standards of business conduct that apply to gifts.

Other baselines include applicable federal, state and other anti-bribery and anti-corruption laws.

3. Identifying and evaluating reasonable alternative regulatory approaches.

One alternative to the draft amendments to Rule G-20 would be for the MSRB not to pursue these amendments, and thus, not regulate municipal

¹⁵ 17 CFR 275.204A-1 (Investment adviser codes of ethics).

¹⁶ See Investment Adviser Codes of Ethics: Release Nos. IA-2256, IC-26492; File No. S7-04-04. In addition, Rule 204-2(a) (12) and (13) of the Investment Advisers Act requires advisers to keep copies of all relevant material relating to the investment adviser code of ethics.

advisors and their associated persons, except dealer/municipal advisors, in connection with gifts and non-cash compensation. In addition, under this alternative, the MSRB would not regulate gifts given by any regulated entity in connection with the municipal advisory activities of the employer of the recipient of the gift. Similarly, under this alternative, the MSRB would not pursue the draft amendments prohibiting a regulated entity from using offering proceeds for certain entertainment expenses.

In the absence of draft amendments extending the rule to include the municipal advisory activities as a covered business category (as to the employer of a recipient of a gift), regulated entities would continue to give gifts or non-cash compensation to a person in connection with the municipal advisory activities of the employer of such gift recipient, with the result that in some instances, a more qualified or less expensive municipal advisor may not be selected, potentially leading to increased costs that would be borne by the municipal entity and investors in its municipal securities, and a reduction of revenues available to be dedicated elsewhere for the benefit of the municipal entity's taxpayers. In sum, by not adopting these draft amendments to Rule G-20, the benefits of the draft amendments could be lost.

Another alternative to the draft amendments would be for the MSRB to require municipal advisors to adopt ethics guidelines similar to those the SEC requires for investment advisers. Such a requirement would be consistent with a regulatory regime contemplated by Congress in the Dodd-Frank Act for municipal advisors that would be comparable to the regulatory regimes for other entities and persons in the financial services industry, in this case investment advisers. However, such a regulatory regime would deviate from the regulatory regime for other municipal securities professionals, such as dealers. Since other regulations for municipal advisors closely mirror regulations for other municipal securities professionals, separately mirroring an investment advisor rule to regulate a municipal advisor's provision of gifts would deviate from the broader regulatory regime that Congress anticipated, and that has been implemented or is in development for municipal advisors.

The MSRB also invites public comment to suggest regulatory alternatives.

4. Assessing the benefits and costs, both quantitative and qualitative, of the draft amendments to Rule G-20 and the main alternative regulatory approaches.

The MSRB policy on economic analysis in rulemaking addresses consideration of the likely costs and benefits of the rule with the draft amendments fully

implemented, against the context of the economic baselines discussed above.

At the outset, the MSRB notes it is currently unable to quantify fully the economic effects of the draft amendments to Rule G-20 that may be amenable to quantification, because the information necessary to provide reasonable estimates is not available.

Benefits

Based on the MSRB's preliminary review, the draft amendments to Rule G-20 are expected to yield several important direct and indirect benefits that will likely be similar to the benefits provided by Rule G-20 as it applies to dealers. One likely benefit of these draft amendments is the reduction of the potential inappropriate influence of gifts and non-cash compensation in the market for allocating the services of municipal advisors.

A benefit of the draft amendments is, compared to the baseline state, it is anticipated to be more likely that municipal advisors will be selected based on merit rather than on the provision of gifts and non-cash compensation to employees of municipal entities or obligated persons. By leveling the playing field upon which municipal advisors compete for business, the draft amendments to Rule G-20 should help minimize or eliminate the potential manipulation of the market for municipal advisory services. The resulting likely benefit to municipal entities and obligated persons will be their ability to obtain more expert, competent, experienced advice at more competitive prices. Investors in municipal bond offerings should also benefit from the draft amendments to Rule G-20 to the extent that a municipal entity that employs a municipal advisor in connection with an issuance of municipal securities may be more likely to receive higher quality municipal advisory services that are priced competitively.

The MSRB expects that the draft amendment to prohibit regulated entities from seeking or obtaining reimbursement of entertainment related expenses from offering proceeds also will yield several important direct and indirect benefits. A benefit of this draft provision is that, compared to the baseline state, it will be more likely that registered municipal securities professionals will be selected based on quality and cost, rather than on their practice of providing entertainment to persons, such as employees of a municipal entity engaged in an offering, and the improper use of offering proceeds for entertainment will be substantially reduced or will cease. The draft amendments to Rule G-20 to prohibit certain uses of offering proceeds would protect investors, municipal entities, and obligated persons from unnecessary expenses in connection with an offering where such expenses are unrelated to preparing for and conducting the offering.

Finally, by integrating MSRB and FINRA interpretive guidance into Rule G-20 the MSRB expects that regulated entities and enforcement agencies will likely realize efficiency gains. In addition, the integration of interpretive guidance will likely reduce the risk of inadvertent violations.

Costs

The MSRB's analysis of the potential costs only focuses on the incremental costs attributable to these draft amendments that exceed the baseline state. The costs associated with the baseline state are, in effect, subtracted from the costs associated with the draft rule to isolate the costs attributable to the incremental requirements of the draft rule.

The costs associated with the requirements of the draft amendments that broaden the application of Rule G-20 to municipal advisors and that broaden the scope of covered business activities to include the municipal advisory activities of the employer of a recipient of a gift will be most pronounced for municipal advisors, who will be required to implement compliance programs for the first time. These start-up costs may be significant for some regulated entities. These costs may include seeking the advice of compliance and legal professionals. In addition, once the compliance programs are implemented, regulated entities will incur recurring costs of maintaining ongoing compliance programs. Start-up compliance costs regarding these draft amendments will disproportionately affect non-dealer municipal advisors since dealer/municipal advisors should have already established compliance programs to comply with the current requirements of Rule G-20.

Relative to the baseline state, the costs associated with the requirements of the draft amendments to prohibit the use of offering proceeds for certain entertainment expenses will include the costs of implementation of compliance programs and will be borne by both dealers and municipal advisors. These start-up costs may be significant for some market participants, and may include the costs of seeking the advice of compliance and legal professionals. The marginal cost for a compliance program associated with this requirement for municipal advisors that are also implementing compliance programs necessary to meet the other requirements of Rule G-20, however, is likely to be relatively small. Once compliance programs are implemented, regulated entities will incur recurring costs of maintaining ongoing programs. The costs associated with the draft amendments to Rule G-20 may fall disproportionately on small municipal advisory firms, including sole proprietorships.

Effect on Competition, Efficiency and Capital Formation

It is possible that the costs associated with the requirements of the draft amendments to Rule G-20 relative to the baseline may lead some municipal advisors to consolidate with other municipal advisors. For example, some municipal advisors may determine to consolidate with other municipal advisors in order to benefit from economies of scale (*e.g.*, by leveraging existing compliance resources of a larger firm) rather than to incur separately the costs associated with the draft amendments to Rule G-20. However, as the SEC recognized in its final rule on the registration of municipal advisors, the market for municipal advisory services is likely to remain competitive despite the potential exit of some municipal advisors (including small entity municipal advisors), the consolidation of municipal advisors, or the lack of new entrants into the market.¹⁷

The MSRB does not expect that the costs associated with the requirements of the draft amendment prohibiting regulated entities from seeking or obtaining reimbursement of entertainment expenses from offering proceeds will have a significant impact on the dealers that currently participate in the municipal securities market nor will it discourage new entrants.

The efficient allocation of municipal advisory services and municipal securities business may be enhanced when the awarding of such services is based on a competition in which the factors are price, quality of performance and service, rather than on the provision of gifts or non-cash compensation, or entertainment during the course of a municipal securities offering. Regulated entities, and particularly smaller regulated entities, will be able to compete on merit rather than their ability or willingness to provide gifts or non-cash compensation or entertainment during the course of an offering of municipal securities. A merit-based competitive process may result in a better allocation of municipal advisory engagements and municipal securities business engagements, compared to the baseline state.

Since the draft amendments apply equally to all registered municipal securities entities, the MSRB does not anticipate that the draft amendments introduce any competitive disadvantages. The MSRB expects that the draft amendments may indirectly foster capital formation by bolstering investor confidence. Investors might be more likely to invest in the municipal securities market, to the extent that they know that municipal advisors providing professional services to clients have taken measures designed to place the duty of loyalty to their municipal entity clients above the municipal advisor's own interest.

¹⁷ See MA Registration Adopting Release at 67608.

General Matters

In addition to any other subject which commenters may wish to address related to draft amended Rule G-20 and the draft amendments to Rules G-8 and G-9, the MSRB seeks public comment on the specific questions below. In particular, the MSRB requests public comment on the potential economic consequences that may result from the adoption of the draft amendments to Rules G-20, G-8 and G-9. The MSRB welcomes information regarding the potential to quantify likely benefits and costs. In addition, the MSRB requests comment to help identify the potential benefits and costs of any regulatory alternatives suggested by commenters. Commenters are encouraged to provide statistical, empirical, and other data that may support their views and/or support or refute the views or assumptions contained in this request for comment.

The MSRB specifically invites commenters to address the following questions:

- 1) How prevalent are “gift giving,” entertainment practices, the use of non-cash compensation in relation to primary offerings and the other practices addressed in Rule G-20 and the draft amendments (“gift giving and other practices”) involving municipal advisors in the municipal securities market? What is the effect of real or perceived gift giving and other practices involving municipal advisors on the municipal securities market? Please provide specific examples of gift giving and other practices not currently addressed in Rule G-20 or the draft amendments involving municipal advisors and that may warrant consideration.
- 2) Do the draft amendments strike the right balance of consistency between the treatment of dealers and municipal advisors, while appropriately accommodating for the differences between these regulated entities? If not, where are differences in treatment warranted that are not reflected in the draft amendments? Conversely, do the draft amendments overemphasize the differences between the regulated entities in a way that is not warranted or desirable?
- 3) Are the exceptions to the \$100 limit appropriate? Should some or all of them be drafted more broadly or narrowly? Should any of them be eliminated?
- 4) Are the various baselines proposed to be used for the purposes of economic analysis appropriate baselines? Are there other relevant baselines that the MSRB should consider?

- 5) If the draft amendments were adopted, what would be the likely effects on competition, efficiency and capital formation?
- 6) Is the proposed extension of the provisions regarding non-cash compensation in connection with primary offerings to municipal advisors appropriate?
- 7) Do commenters believe that the draft amendments explicit prohibition of seeking and or obtaining reimbursement for entertainment expenses from the proceeds on an issuance of municipal securities is appropriate? Is the term, "entertainment expenses," which is defined for the purposes of this prohibition, appropriately tailored?
- 8) Are the recordkeeping requirements that apply to dealers in existing Rule G-20 and the analogous draft requirements that would apply to municipal advisors appropriately tailored to obtain information that is relevant for the purposes of Rule G-20? Are there additional costs or benefits to the recordkeeping obligations that the MSRB should consider?
- 9) What would be the effect of draft amended Rule G-20 for dealers that have instituted long-standing compliance programs? What would be the effect of draft amended Rule G-20 for dealer-municipal advisors that have instituted long-standing compliance programs? Do dealers or dealer-municipal advisors anticipate that any of the draft amendments to Rule G-20 would increase or decrease either the occurrence of, or the perception of, gift giving and other practices addressed in Rule G-20 and the draft amendments in order to obtain or retain municipal securities or municipal advisory business in the municipal securities market?
- 10) What alternative methods should the MSRB consider in addressing the potential for improprieties related to gift giving and other practices addressed in current Rule G-20 and the draft amendments to Rule G-20?

October 23, 2014

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Text of Draft Amendments¹⁸

Rule G-20: Gifts, Gratuities, ~~and~~ Non-Cash Compensation and Expenses of Issuance

(a) Purpose. The purpose of this rule is to maintain the integrity of the municipal securities market and to preserve investor and public confidence in the municipal securities market, including the bond issuance process. The rule protects against improprieties and conflicts that may arise when regulated entities or their associated persons give gifts or gratuities to persons in relation to the municipal securities or municipal advisory activities of the recipients' employers.

~~(b)~~(e) Definitions. For purposes of this rule, the following terms have the following meanings:

~~(i)(ii)~~(i) The term "cash compensation" shall mean any discount, concession, fee, service fee, commission, asset-based sales charge, loan, override or cash employee benefit received in connection with the sale and distribution of municipal securities.

~~(ii)(i)~~(ii) The term "non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of municipal securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

~~(iii)~~(iii) The term "offeror" shall mean, with respect to a primary offering of municipal securities, the issuer, any adviser to the issuer (including but not limited to the issuer's financial advisor, municipal advisor, bond or other legal counsel, or investment or program manager in connection with the primary offering), the underwriter of the primary offering, or any person controlling, controlled by, or under common control with any of the foregoing; provided, however, that, with respect to a primary offering of municipal fund securities, "offeror" shall also include any person considered an "offeror" under ~~NASD Rule 2710, NASD Rule 2820~~ FINRA Rules 5110, 2320, or NASD Rule 2830 in connection with any securities held as assets of or underlying such municipal fund securities.

(iv) "Person" means a natural person.

~~(v)(iv)~~(v) The term "primary offering" shall mean a primary offering as defined in Securities Exchange Act Rule 15c2-12(f)(7).

(vi) "Regulated entity" means a broker, dealer, municipal securities dealer or municipal advisor, but does not include the associated persons of such entity.

~~(c)(a)~~(c)(a) General Limitation on Value of Gifts and Gratuities. No regulated entity or any of its associated persons ~~broker, dealer or municipal securities dealer~~ shall, directly or indirectly, give or provide or permit to be given or provided any thing or service of value, including gratuities, in excess of \$100 per year to a person (other than an employee or partner of such regulated entity), ~~broker, dealer or municipal securities dealer~~, if such payments or services are in relation to the municipal securities or municipal advisory activities of the employer of the recipient of the payment or service. For purposes of this rule the term

¹⁸ Underlining indicates new language; strikethrough denotes deletions.

"employer" shall include a principal for whom the recipient of a payment or service is acting as agent or representative.

(d)(b) Normal Business Dealings. Notwithstanding the foregoing, the provisions Gifts and Gratuities Not Subject to General Limitation. The general limitation of section (c)(a) of this rule shall not be deemed apply to prohibit occasional the following gifts of meals or tickets to theatrical, sporting, and other entertainments hosted by the broker, dealer or municipal securities dealer; the sponsoring by the broker, dealer or municipal securities dealer of legitimate business functions, provided that they are recognized by the Internal Revenue Service as deductible business expenses; or gifts of reminder advertising; provided, that such gifts shall not be not so frequent or so extensive as to raise any question of propriety or to give rise to any apparent or actual material conflict of interest.;

(i) Normal Business Dealings. Occasional gifts of meals or tickets to theatrical, sporting, and other entertainments that are hosted by the regulated entity or its associated persons, and the sponsoring by the regulated entity of legitimate business functions that are recognized by the Internal Revenue Service as deductible business expenses.

(ii) Transaction-Commemorative Gifts. Gifts that are solely decorative commemorating a business transaction, such as a customary desk ornament (e.g., Lucite tombstone) or plaque.

(iii) De Minimis Gifts. Gifts of de minimis value (e.g., pens, notepads or modest desk ornaments).

(iv) Promotional Gifts. Promotional items of nominal value displaying the regulated entity's corporate or other business logo. The value of the item must be substantially below the general \$100 limit to be considered of nominal value.

(v) Bereavement Gifts. Bereavement gifts that are reasonable and customary for the circumstances.

(vi) Personal Gifts. Gifts that are personal in nature (e.g., a wedding gift or a congratulatory gift for the birth of a child).

(e) Prohibition of Use of Offering Proceeds. A regulated entity that engages in municipal securities activities or municipal advisory activities for or on behalf of a municipal entity in connection with an offering of municipal securities by such municipal entity is prohibited from requesting or obtaining reimbursement of its costs and expenses related to the entertainment of any person, including (but not limited to) any official or other personnel of the municipal entity, from the proceeds of the offering of such municipal securities. For purposes of this prohibition, entertainment expenses do not include reasonable and necessary expenses for meals hosted by the regulated entity and directly related to the offering for which the regulated entity was retained.

(f)(e) Compensation for Services. The general limitation Notwithstanding the foregoing, the provisions of section (c)(a) of this rule shall not apply to contracts of employment with or to compensation for services rendered by another person; provided, that there is in existence prior to the time of employment or before the services are rendered a written agreement between the regulated entity broker, dealer or

~~municipal securities dealer subject to this rule and the person who is to perform such services; and provided, further, that such agreement includes shall include~~ the nature of the proposed services, the amount of the proposed compensation, and the written consent of such person's employer.

~~(g)(d)~~ *Non-Cash Compensation in Connection with Primary Offerings.* In connection with the sale and distribution of a primary offering of municipal securities, no ~~broker, dealer or municipal securities dealer~~ regulated entity, or any associated person thereof, shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation. Notwithstanding the foregoing and the provisions of section ~~(c)(a)~~ of this rule, the following non-cash compensation arrangements are permitted:

(i) - (ii) No change.

(iii) payment or reimbursement by offerors in connection with meetings held by an offeror or by a ~~broker, dealer or municipal securities dealer~~ regulated entity for the purpose of training or education of associated persons of a ~~broker, dealer or municipal securities dealer~~ regulated entity, provided that:

(A) associated persons obtain the prior approval of the ~~broker, dealer or municipal securities dealer~~ regulated entity to attend the meeting and attendance is not preconditioned by the ~~broker, dealer or municipal securities dealer~~ regulated entity on achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph ~~(g)(iv) (d)(iv)~~;

(B) the location is appropriate to the purpose of the meeting, which shall mean an office of the offeror or the ~~broker, dealer or municipal securities dealer~~ regulated entity, a facility located in the vicinity of such office, a regional location with respect to regional meetings, or a location at which a significant asset, if any, being financed or refinanced in the primary offering is located;

(C) No change.

(D) the payment or reimbursement is not preconditioned by the offeror on achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph ~~(g)(iv) (d)(iv)~~.

(iv) non-cash compensation arrangements between a ~~broker, dealer or municipal securities dealer~~ regulated entity and its associated persons, or a company that controls the ~~broker, dealer or municipal securities dealer~~ regulated entity and the associated persons of the ~~broker, dealer or municipal securities dealer~~ regulated entity, provided that:

(A) the non-cash compensation arrangement is based on the total production of associated persons with respect to all municipal securities within respective product types distributed by the ~~broker, dealer or municipal securities dealer~~ regulated entity;

(B) No change.

(C) no entity that is not an associated person of the ~~broker, dealer or municipal securities dealer~~ regulated entity participates directly or indirectly in the organization of a permissible non-cash compensation arrangement.

(v) contributions by any person other than the ~~broker, dealer or municipal securities dealer~~ regulated entity to a non-cash compensation arrangement between a ~~broker, dealer or municipal securities dealer~~ regulated entity and its associated persons, provided that the arrangement meets the criteria in paragraph ~~(g)(iv)~~ (d)(iv).

~~(e) Definitions.~~ - Moved to paragraph (b)

Supplementary Material

.01 Personal Gifts. A gift that is personal in nature is not subject to the general limitation in section (c) of this rule because that limitation applies only to payments or services that are in relation to the municipal securities or municipal advisory activities of the employer of the recipient. In determining whether a gift is personal in nature and not in relation to such activities of the employer of the recipient, a number of factors will be considered, including but not limited to the nature of any pre-existing personal or family relationship between the associated person giving the gift and the recipient and whether the associated person or the regulated entity with which he or she is associated paid for the gift. When a regulated entity bears the cost of a gift, either directly or by reimbursing an associated person, the gift will be presumed to be given in relation to the municipal securities or municipal advisory activities, as applicable, of the employer of the recipient within the meaning of the general limitation in section (c) of this rule.

.02 Applicability of State or Other Laws. Regulated entities and their associated persons may be subject to other duties, restrictions or obligations under state or other laws. Nothing contained in this rule shall be deemed to supersede any more restrictive provision of state or other laws applicable to the activities of regulated entities or their associated persons.

* * * * *

Rule G-8: Books and Records to be Made by Brokers, Dealers, ~~and~~ Municipal Securities Dealers and Municipal Advisors¹⁹

(a) *Description of Books and Records Required to be Made.* Except as otherwise specifically indicated in this rule, every broker, dealer and municipal securities dealer shall make and keep current the following books and records, to the extent applicable to the business of such broker, dealer or municipal securities dealer:

¹⁹ The MSRB has multiple rulemaking initiatives that would revise Rules G-8 and G-9. The markings contained in this attachment reflect the substance of the revisions related to this recommendation and technical or non-substantive changes will be made as necessary depending on the progress of this and the other rulemaking initiatives.

(i) - (xvi) No change.

(xvii) *Records Concerning Compliance with Rule G-20*. Each broker, dealer and municipal securities dealer shall maintain:

(A) a separate record of any gift or gratuity referred to in Rule G-20~~(c)(a)~~;

(B) all agreements referred to in Rule G-20~~(f)(e)~~ and records of all compensation paid as a result of those agreements; and

(C) records of all non-cash compensation referred to in Rule G-20~~(g)(d)~~. The records shall include the name of the person or entity making the payment, the name~~(s)~~ of the associated person~~(s)~~ receiving the payments (if applicable), and the nature (including the location of meetings described in Rule G-20~~(g)(iii) (d)(iii)~~, if applicable) and value of non-cash compensation received.

(xviii) - (xxvi) No change.

(b) - (g) No change.

(h) *Municipal Advisor Records*. Every municipal advisor that is registered or required to be registered under section 15B of the Act and the rules and regulations thereunder shall make and keep current the following books and records:²⁰

(i) Reserved.

(ii) *Records Concerning Compliance with Rule G-20*.

(A) a separate record of any gift or gratuity described in Rule G-20(c); and

(B) all agreements referred to in Rule G-20(f) and records of all compensation paid as a result of those agreements.

(iii) Reserved.

(iv) Reserved.

(v) Reserved.

* * * * *

²⁰ Draft Rule G-8(h) includes reserved subparagraph (iii) for books and records provisions that the MSRB has proposed in connection with draft amendments to Rule G-37, subparagraph (iv) for books and records provisions that the MSRB has proposed in connection with proposed new Rule G-42, and subparagraphs (i) and (v) for books and records provisions that the MSRB has proposed in connection with proposed new Rule G-44.

Rule G-9: Preservation of Records

(a) *Records to be Preserved for Six Years.* Every broker, dealer and municipal securities dealer shall preserve the following records for a period of not less than six years:

(i) - (xiii) No change.

(xiv) Reserved.

(b) - (g) No change.

(h) *Municipal Advisor Records.*

(i) Subject to paragraphs (ii), (iii) and (iv) of this section, every municipal advisor shall preserve the books and records described in Rule G-8(h) for a period of not less than five years.

(ii) Reserved.

(iii) Reserved.

(iv) The records described in Rule G-8(h)(ii) shall be preserved for at least five years.

(i) Reserved.²¹

(j) Reserved.

(k) Reserved.

²¹ Draft amended Rule G-9 includes reserved sections (i) - (k) for preservation of records, which the MSRB proposed in connection with proposed new Rule G-44.