MSRB REPORTS

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Calendar

June 3 — Effective date of amendments to rule G-37, on political contributions and prohibitions on municipal securities business, and rule G-8, on recordkeeping

July 31 — Due date for Form G-37 to be filed with the Board (for the period April 25, 1994 – June 30, 1994)

Aug. 19 — Effective date of amendments to rules G-8 and G-9, on recordkeeping and record retention, respectively, that relate to rule G-20, on gifts and gratuities

Sept. 15 — Comments due on draft amendment to rule G-15(a), on customer confirmations

Oct. 15 — Comments due on draft amendment to rule G-3 concerning continuing education requirements

Oct. 31 — Due date for Form G-37 to be filed with the Board (for the period July 1, 1994 – September 30, 1994)

Oct. 31 — Annual fee payment to Board is due (dealers will be sent an invoice)

Pending
— Amendments to rules G-12 and G-15 concerning T+3 settlement
— Amendment to rule G-14, on reports of sales or purchases, and associated transaction reporting procedures
— Amendments to rule G-37, on political contributions and prohibitions on municipal securities business, and rule G-8, on recordkeeping
— Amendment to rule G-34, on CUSIP numbers and dissemination of initial trade date information
— Amendment to rule A-13, on underwriting assessment

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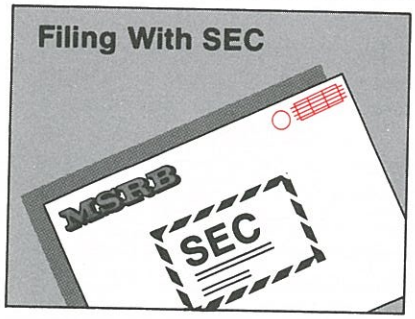

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- ☐ Other

T+3 Settlement: Rules G-12 and G-15

Amendments Filed

The Board has filed amendments to rule G-12 on uniform practice and rule G-15 on confirmation, clearance and settlement of transactions with customers, with the Securities and Exchange Commission redefining "regular-way" settlement as three business days (T+3 settlement).

On October 6, 1993, the Securities and Exchange Commission (Commission) approved Securities Exchange Act Rule 15c6-1 which institutes a national goal of shortening the standard settlement time frame for most types of securities transactions to three business days (T+3 settlement).[1] Although municipal securities were not included within the scope of Securities Exchange Act Rule 15c6-1, the Commission formally requested that the Board undertake a commitment to T+3 settlement for municipal securities to ensure consistency in settlement cycles in the corporate and municipal markets. The Commission also asked the Board to provide a plan for implementing T+3 settlement in the municipal securities market.[2] In response, the Board provided the *Report of the Municipal Securities Rulemaking Board on T+3 Settlement for the Municipal Securities Market* (*T+3 Report*) to the Commission in March 1994.[3]

Summary of Proposed Amendments

As part of the plan to implement T+3 settlement in the municipal securities market, the Board, on August 9, 1994, filed amendments to rule G-12 on uniform practice and rule G-15 on confirmation, clearance and settlement of transactions with customers.[4] The proposed amendments would define "regular-way" settlement in municipal securities transactions to be three, rather than five, business days.[5] The proposed amendments track the language of Rule 15c6-1(a) in allowing settlement dates in the secondary market to be extended, by the agreement of the parties to a transaction, on a case by case basis. However, any such agreements must be reached on each individual transaction at the time of trade; dealers will not be able to retain T+5 settlement as standard practice.

The amendments exempt "when, as and if issued" transactions from the requirement for T+3 settlement. Currently, when, as and if issued transactions are not settled in five business days and the Board does not believe that it would be possible—given the various actions necessary to accomplish settlement (or closing) with the issuer of municipal securities—to institute a three-day settlement cycle for these transactions.[6] The amendments also include changes to rule G-15(d)(i) relating to institutional customer delivery instructions on delivery vs. payment and receipt vs. payment (DVP/RVP) settlement to reflect a three-day, rather than five-day settlement cycle.

The Board has requested that the Commission delay effectiveness of the amendments until the effectiveness of Exchange Act Rule 15c6-1—currently set for June 1, 1995—to allow the municipal securities market to convert to three-day settlement simultaneously with the corporate securities market.[7]

Questions about the proposed amendments may be directed to Judith A. Somerville, Uniform Practice Specialist.

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[1] *See* Securities Exchange Act Release No. 34-33023 (October 6, 1993).

[2] *See* letter from Arthur Levitt, Chairman, SEC to David Clapp, Chairman, MSRB (October 7, 1993) reprinted in *MSRB Reports* Vol. 14, No. 2, (March 1994) at 3.

[3] *MSRB Reports,* Vol. 14, No. 2 (March 1994) at 5-14.

4 File No. SR-MSRB-94-10. Comments submitted to the Commission should refer to the file number.

[5] In its *T+3 Report*, the Board proposed to file these amendments in March 1995, for effectiveness in June 1995, to coincide with the effective date of Rule 15c6-1. By a letter dated April 1994, the Commission asked the Board to consider filing these amendments as early as June 1994 to provide early notice to the industry of the Board's commitment to T+3 settlement. The Board accordingly has accelerated the filing of the amendments.

[6] A dealer cannot settle with a customer or another dealer prior to the final settlement (or closing) of the issue with the issuer. The closing date with an issuer is dependent upon many factors including the preparation of a number of closing documents and cannot necessarily be scheduled within three days after trading begins in an issue. *See T+3 Report* at 14.

[7] At a July 25, 1994, meeting hosted by SEC staff, representatives of the various self-regulatory organizations and SEC staff discussed the possibility of a short transition period during June 1995. The Board will file additional rule changes if necessary to obtain consistency with the final transition plans of the SEC for Rule 15c6-1.

Discussion

The *T+3 Report* discussed the need for certain changes in industry practice relating to retail customers if T+3 settlement is to be accomplished. Specifically, practices relating to how retail customers make payment to dealers and how retail customers holding securities certificates deliver those certificates to dealers will have to be reviewed.[8] While the Board understands that making the adjustments as necessary for T+3 settlement will be a challenge, the Board also is convinced that there would be serious operational difficulties in the securities industry if the municipal securities market does not convert to T+3 settlement at the same time as other securities markets. The potential problems involving retail customers in municipal securities are similar to those in the corporate securities market and the Board believes that municipal securities dealers can overcome these problems in a similar manner and within the same time frame.

The Board continues to participate in efforts to assist the industry in the transition to T+3 settlement. As noted in the *T+3 Report,* the initial comparison rate for inter-dealer transactions must improve to achieve T+3 settlement. The Board recently coordinated the implementation of an enforcement initiative designed to increase the comparison rate. The Board also continues to participate in efforts by industry groups, such as the Securities Industry Association and the Public Securities Association, concerning the development of educational initiatives for customers and dealers. Additionally, the Board plans to file an amendment to rule G-34 on CUSIP Numbers and Dissemination of Initial Trade Date Information with the Commission which, if approved, would require newly-issued municipal securities to be made depository eligible. The proposed amendment is designed to facilitate book-entry settlement of transactions in municipal securities, since it may be difficult or even impossible for dealers and institutional customers to make timely T+3 DVP/RVP settlements with deliveries of physical certificates.

August 9, 1994

Text of Proposed Amendments*

G-12. Uniform Practice

(a) No change.
(b) Settlement Dates.
(i) No change.
(ii) Settlement dates. Settlement dates shall be as follows:
(A) for "cash" transactions, the trade date;
(B) for "regular way" transactions, the ~~fifth~~ third business day following the trade date;
(C) for "when, as and if issued" transactions, a date agreed upon by both parties, which date shall not be earlier than the fifth business day following the date the confirmation indicating the final settlement date is sent, or, with respect to transactions between the manager and members of a syndicate or account formed to purchase securities from an issuer, a date not earlier than the sixth business day following the date the confirmation indicating the final settlement date is sent; *provided, however,* that for when, as and if issued transactions compared through the automated comparison facilities of a registered clearing agency under section (f) of this rule, a managing underwriter shall provide the registered clearing agency with the settlement date as soon as it is known and shall immediately inform the registered clearing agency of any changes in such settlement date; and
(D) for all other transactions, a date agreed upon by both parties, *provided, however,* that a broker, dealer or municipal securities dealer shall not effect or enter into a transaction for the purchase or sale of a municipal security (other than a "when, as and if issued" transaction) that provides for payment of funds and delivery of securities later than the third business day after the date of the transaction unless expressly agreed to by the parties, at the time of the transaction.
(c) - (l) No change.

G-15. Confirmation, Clearance and Settlement of Transactions with Customers

(a) No change.
(b) Settlement Dates.
(i) No change.
(ii) Settlement Dates. Settlement dates shall be as follows:
(A) for "cash" transactions, the trade date;
(B) for "regular way" transactions, the ~~fifth~~ third business day following trade date;
(C) for all other transactions, a date agreed upon by both parties, *provided, however,* that a broker, dealer or municipal securities dealer shall not effect or enter into a transaction for the purchase or sale of a municipal security (other than a "when, as and if issued" transaction) that provides for payment of funds and delivery of securities later than the third business day after the date of the transaction unless expressly agreed to by the parties at the time of the transaction.
(c) No change.
(d) Delivery/Receipt vs. Payment Transactions.
(i) No broker, dealer or municipal securities dealer shall accept an order from a customer pursuant to an arrangement whereby payment for securities received (RVP) or delivery against payment of securities sold (DVP) is to be made to or by an agent of the customer unless all of the following procedures are followed:
(A) the broker, dealer or municipal securities dealer

[8] Since the publication of the *T+3 Report*, the Board has received several letters from dealers expressing concerns about retail customer practices.

* Underlining indicates new language; strikethrough denotes deletions.

shall have received from the customer prior to or at the time of accepting such order, the name and address of the agent and the name and account number of the customer on file with the agent;

(B) the memorandum of such order made in accordance with the requirements of paragraph (a)(vi) or (a)(vii) of rule G-8 shall include a designation of the fact that it is a delivery vs. payment (DVP) or receipt vs. payment (RVP) transaction;

(C) the broker, dealer or municipal securities dealer shall give or send to the customer a confirmation in accordance with the requirements of section (a) of the rule with respect to the execution of the order not later than the close of business on the next business day after any such execution; and

(D) the broker, dealer or municipal securities dealer shall have obtained a representation from the customer (1) that the customer will furnish the agent instructions with respect to the receipt or delivery of the securities involved in the transaction promptly and in a manner to assure that settlement will occur on settlement date, ~~upon receipt by the customer of each confirmation, or the relevant data as to each execution, relating to such order,~~ and (2) that, with respect to a transaction subject to the provisions of paragraph (ii) below, the customer will furnish the agent such instructions in accordance with the rules of the registered clearing agency through whose facilities the transaction has been or will be confirmed~~, and (3) that, with respect to all other transactions, the customer will assure that such instructions are delivered to the agent no later than:~~

~~(a) in the case of a purchase by the customer where the broker, dealer or municipal securities dealer is to deliver the securities to the customer's agent against payment (DVP), the close of business on the fourth business day after the trade date of execution of the transaction as to which the particular confirmation relates; or~~

~~(b) in the case of a sale by the customer where the broker, dealer or municipal securities dealer is to receive the securities from the customer's agent against payment (RVP), the close of business on the third business day after the date of execution of the transaction as to which the particular confirmation relates.~~

(ii) - (iii) No change.

(e) No change.

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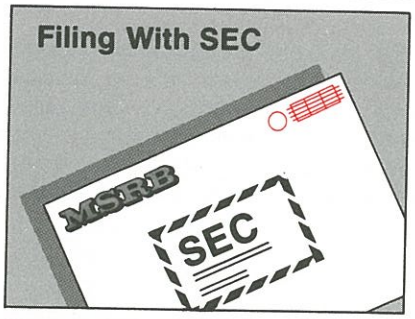

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Reporting Inter-Dealer Transactions to the Board: Rule G-14

Amendment and Transaction Reporting Procedures Filed

The amendment would require dealers to report inter-dealer transaction information to the Board or its designee. The transaction information would be used to make public reports of market activity and prices and would be made available to the regulatory agencies responsible for the enforcement of Board rules. The transaction reporting procedures designate National Securities Clearing Corporation as the Board's agent to receive transaction information.

On June 20, 1994, the Board filed with the Securities and Exchange Commission (Commission) a proposed amendment to rule G-14, on reports of sales or purchases, and associated transaction reporting procedures.[1] The proposed amendment would require brokers, dealers and municipal securities dealers (dealers) to report inter-dealer transaction information to the Board or its designee. The Board also filed with the Commission the procedures that dealers would be required to use to report transactions.

The information collected under the proposed amendment and procedures represents a first step in the Board's plan to achieve "transparency" in the municipal securities market. Under the Board's plan, aggregate data about market activity and certain volume and price information about frequently traded securities would be disseminated to promote investor confidence in the market and its pricing mechanisms. In addition, all transaction information collected would be made available to regulatory agencies responsible for enforcement of Board rules as a means to assist in the inspection for compliance with, and the enforcement of, Board rules. The Board plans, in the future, to enhance the transaction reporting program by including institutional and retail customer transactions, with the ultimate goal of disseminating comprehensive, contemporaneous pricing data. The Board plans to make the system for transaction reporting operational by January 2, 1995.[2]

Background

In May 1993, the Board released for comment a notice proposing a pilot program to collect and publish information on transactions occurring in the inter-dealer market for municipal securities (the "pilot program").[3] In January 1994, the Board described and addressed the comments received in response to the notice, and announced its decision to implement the pilot program.[4] The pilot program would make information available in the form of a daily, public report containing volume and pricing information for the inter-dealer market on the previous business day (the "daily report"). For each day of trading the daily report would include the following aggregate information about the market:

(i) total par value traded;
(ii) total number of compared transactions; and
(iii) total number of issues traded (*i.e.*, the number of different CUSIP numbers that were involved in compared transactions on that day)

The frequently traded issues to be reported individually each day would be those that traded at or above a threshold number of times on the previous business day. Initially, the threshold will be four trades per day. For each of these issues, the daily report would provide the high, low and average prices of transactions in the issue, along with total par value traded and the number of trades in the issue.[5] The pilot program also would make information on all inter-dealer trades in municipal securities available to the Commission and other regulatory agencies to assist in the inspection for compliance with, and the enforcement of, Board rules.

Questions about the proposed amendment may be directed to Larry M. Lawrence, Policy and Technology Advisor.

[1] File No. SR-MSRB-94-9. Persons wishing to comment on the amendment should comment directly to the Commission, referring to the file number.
[2] Prior to that time, the Board will make another filing with the Commission with fees for subscribing to the daily report and further technical details.
[3] "Planned Pilot Program for Publishing Inter-Dealer Transaction Information," *MSRB Reports*, Vol. 13, No. 3 (June 1993) at 3.
[4] "Board to Proceed with Pilot Program to Disseminate Inter-Dealer Transaction Information," *MSRB Reports*, Vol. 14, No. 1 (January 1994) at 13.
[5] The average prices (but not the high and low prices) would initially be calculated based upon those trades in a "band" of $100,000 to $1 million par value. The prices and par values of individual transactions would not be included in the daily report.

Summary of Amendment to Rule G-14

There is currently no requirement for public reporting of transactions in municipal securities. In its present form, the Board's rule G-14, on reports of sales or purchases, does not require the reporting of transactions in municipal securities, but does require that a dealer that distributes or publishes a report of a transaction in a municipal security know or have reason to believe that the transaction was actually effected and have no reason to believe that the transaction was fictitious or in furtherance of any fraudulent, misleading or deceptive purpose.

The proposed amendment to rule G-14 would impose a duty upon dealers to report all inter-dealer transactions to the Board or its designee. It states that such information would be used by the Board to make public reports and would be provided to the Commission, the NASD, and bank regulatory organizations charged with enforcing Board rules.

Summary of G-14 Transaction Reporting Procedures

Dealers would report transactions under the proposed rule G-14 transaction reporting procedures. The transaction reporting procedures designate National Securities Clearing Corporation (NSCC) as the Board's agent to receive transaction information. NSCC is a clearing agency registered with the Commission under Section 17A of the Securities and Exchange Act and is the central facility for automated comparison processing for inter-dealer municipal securities transactions.

Currently, pursuant to the Board's rule G-12(f)(i) on automated comparison, dealers must use the facilities of a registered clearing agency to compare all inter-dealer transactions in securities with CUSIP numbers. The proposed transaction reporting procedures specify that the timeframe and format requirements for submitting information to a registered clearing agency for automated comparison would also apply for purposes of trade reporting under the proposed amendment. Thus, under the proposed pilot program, dealers would not have to submit trade data to a separate reporting system and would not incur additional operational costs.

The proposed procedures state that dealers may provide transaction information either to NSCC or to any other registered clearing agency linked with NSCC for the purpose of automated comparison.[6] Dealers may submit transaction information directly to the registered clearing agency or through an agent that is a member of the registered clearing agency.[7] In addition, the proposed procedures would require the dealer to report the amount of accrued interest for the transaction if the settlement date of a transaction is known by the dealer, to enable the accurate computation of price in certain transactions.[8]

With one exception, NSCC automated comparison procedures require both the purchasing and selling dealers to submit information about the trade. Thus, the proposed reporting procedures require transaction information to be submitted by both parties. However, for transactions involving the distribution of new issue securities from a syndicate manager to syndicate members, NSCC comparison procedures require only a submission from the syndicate manager. The proposed procedures allow for the same "one-sided" submission of transaction information for syndicate trades.

August 3, 1994

Text of Proposed Amendment and Procedures*

Rule G-14. Reports of Sales or Purchases

(a) No ~~municipal securities~~ broker, dealer or municipal securities dealer or person associated with a ~~municipal securities~~ broker, dealer or municipal securities dealer shall distribute or publish, or cause to be distributed or published, any report of a purchase or sale of municipal securities, unless such ~~municipal securities~~ broker, dealer or municipal securities dealer or associated person knows or has reason to believe that the purchase or sale was actually effected and has no reason to believe that the reported transaction is fictitious or in furtherance of any fraudulent, deceptive or manipulative purpose. For purposes of this rule, the terms "distributed" or "published" shall mean the dissemination of a report by any means of communication.

(b) Each broker, dealer or municipal securities dealer shall report to the Board or its designee information about its transactions in municipal securities with other brokers, dealers or municipal securities dealers using the formats and within the timeframes specified in Rule G-14 Transaction Reporting Procedures. Transaction information collected by the Board under this rule will be used to make public reports of market activity and prices and will be made available by the Board to the Commission, securities associations registered under Section 15A of the Act and other appropriate regulatory agencies defined in Section 3(a)(34)(A) of the Act to assist in the inspection for compliance with and the enforcement of Board rules.

Rule G-14 Transaction Reporting Procedures

(a) *Inter-Dealer Transactions.*

(i) Except as described in paragraph (ii) of this section (a), each broker, dealer and municipal securities dealer shall report all transactions with other brokers, dealers or municipal securities dealers to the Board's designee for receiving such transaction information. The Board has designated National Securities Clearing Corporation (NSCC) for this purpose. A broker, dealer or municipal securities dealer shall report a transaction by submitting or causing to be submitted to NSCC information in such format and within such timeframe as required by NSCC to produce a compared trade for the transaction in the

[6] All the registered clearing agencies offering municipal securities comparison services are linked with NSCC by automated interfaces.

[7] The primary responsibility for timely and accurate submission continues to rest with the executing dealer, whether or not an agent is used.

[8] The Board intends to report all trades on the basis of the dollar price of the security. When dealers submit trade information on the basis of yield or total contract amount, the computation of dollar price will require an entry for accrued interest.

* Underlining indicates additions; strikethrough denotes deletions.

initial comparison cycle on the night of trade date in the automated comparison system operated by NSCC. Such transaction information may be submitted to NSCC directly or to another registered clearing agency linked for the purpose of automated comparison with NSCC. The broker, dealer or municipal securities dealer may employ an agent that is a member of NSCC or a registered clearing agency for the purpose of submitting transaction information; however, the primary responsibility for timely and accurate submission continues to rest with the broker, dealer or municipal securities dealer that executed the transaction. If the settlement date of a transaction is known by the broker, dealer or municipal securities dealer, the report made to NSCC also shall include a value for accrued interest in the format prescribed by NSCC.

(ii) A transaction that is not eligible to be compared in the automated comparison system operated by NSCC (because of the lack of a CUSIP number for the security or other reasons) shall not be required to be reported under this section (a). A transaction that is subject to a "one-sided" submission procedure in the automated comparison system operated by NSCC shall be reported only by the broker, dealer or municipal securities dealer that is required to submit the transaction information under the one-sided submission procedure.

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Continuing Education Requirements: Rule G-3

Comments Requested

The Board requests comments on a draft amendment to establish a formal, two-part continuing education program for securities industry professionals that would require uniform training on regulatory matters and ongoing programs by firms to keep their registered persons up to date on job-specific subjects.

The Board is seeking comment on rule proposals developed by the Industry/Regulatory Council on Continuing Education (the Council).[1] These proposals codify and expand the conceptual recommendations made by a special task force comprised entirely of industry representatives and published by six self-regulatory organizations (SROs)[2] in September 1993. The draft amendment would establish a formal, two-part continuing education program for securities industry professionals that would require uniform training on regulatory matters and ongoing programs by firms to keep their registered persons up to date on job-specific subjects.

The continuing education requirements will be applicable to individuals employed by securities firms and bank dealers. Background information and an explanation of the rule proposals, including questions and answers regarding the continuing education proposal, are contained on pages 15 - 21 of this issue.

August 15, 1994

Text of Draft Amendment*

Rule G-3. Classification of Principals and Representatives; Numerical Requirements; Testing; Continuing Education Requirements

No broker, dealer or municipal securities dealer or person who is a municipal securities representative, municipal securities principal, municipal securities sales principal or financial and operations principal (as hereafter defined) shall be qualified for purposes of rule G-2 unless such broker, dealer or municipal securities dealer or person meets the requirements of this rule.

(a) - (g) No change.

(h) Continuing Education Requirements

This section (h) prescribes requirements regarding the continuing education of certain registered persons subsequent to their initial qualification and registration with a registered securities association with respect to a person associated with a member of such association, or the appropriate regulatory agency as defined in section 3(a)(34) of the Act with respect to a person associated with any other broker, dealer or municipal securities dealer ("the appropriate enforcement authority"). The requirements shall consist of a Regulatory Element and a Firm Element as set forth below.

(i) Regulatory Element

(A) Requirements — No broker, dealer or municipal securities dealer shall permit any registered person to continue to, and no registered person shall continue to, perform duties as a registered person, unless such person has complied with the requirements of section (i) hereof.

(1) Each registered person shall complete the Regulatory Element on three occasions, at intervals of two, five and 10 years after the effective date of their registration, or as otherwise prescribed by the Board. On each of the three occasions, the Regulatory Element must be completed within one hundred twenty days after the person's registration anniversary date. The content of the Regulatory Element shall be prescribed by the Board.

(2) Registered persons who have been continuously registered for more than 10 years

Comments on the draft amendment should be submitted no later than October 15, 1994, and may be directed to Ronald W. Smith, Legal Associate, or Loretta J. Rollins, Professional Qualifications Administrator.

[1] The Board has incorporated these rule proposals as a draft amendment to rule G-3, on professional qualifications.

[2] The six SROs include the American Stock Exchange (AMEX), the Chicago Board Options Exchange (CBOE), the Municipal Securities Rulemaking Board (MSRB), the National Association of Securities Dealers, Inc. (NASD), the New York Stock Exchange (NYSE), and the Philadelphia Stock Exchange (PHLX).

* Underlining indicates new language.

as of the effective date of this section shall be exempt from participation in the Regulatory Element, provided such persons have not been subject to any disciplinary action within the last 10 years as enumerated in paragraphs (i)(C)(1)-(2). In the event of such disciplinary action, a person will be required to satisfy the requirements of the Regulatory Element by participation for the period from the effective date of this section to 10 years after the occurrence of the disciplinary action.

(3) Persons who have been currently registered for 10 years or less as of the effective date of this section shall initially participate in the Regulatory Element within 120 days after the occurrence of the second, fifth or tenth registration anniversary date, whichever anniversary date first applies, and on the applicable registration anniversary date(s) thereafter. Such persons will have satisfied the requirements of the Regulatory Element after participation on the tenth registration anniversary.

(4) All registered persons who have satisfied the requirements of the Regulatory Element shall be exempt from further participation in the Regulatory Element, subject to re-entry into the program as set forth in paragraph (i)(C).

(B) Failure to Complete — Unless otherwise determined by the Board, any registered persons who have not completed the Regulatory Element within the prescribed time frames will have their registrations deemed inactive until such time as the requirements of the program have been satisfied. Any person whose registration has been deemed inactive under this section shall cease all activities as a registered person and is prohibited from performing any duties and functioning in any capacity requiring registration. The appropriate enforcement authority may, upon application and a showing of good cause, allow for additional time for a registered person to satisfy the program requirements.

(C) Re-entry into Program — Unless otherwise determined by the appropriate enforcement authority, a registered person will be required to re-enter the Regulatory Element and satisfy the program's requirements in their entirety commencing with initial participation within 120 days of a disciplinary action becoming final, and on three additional occasions thereafter, at intervals of two, five and 10 years after re-entry, notwithstanding that such person has completed all or part of the program requirements based on length of time as a registered person or completion of ten years of participation in the program, whenever the registered person has been:

(1) subject to any statutory disqualification as defined in Section 3(a)(39) of the Securities Exchange Act of 1934;

(2) subject to suspension or to the imposition of a fine of $5,000 or more for violation of any provision of any securities law or regulation, or any agreement with or rule or standard of conduct of any securities governmental agency, securities self-regulatory organization, the appropriate enforcement authority, or as imposed by any such regulatory or self-regulatory organization in connection with a disciplinary proceeding; or

(3) ordered to re-enter the continuing education program by the Securities and Exchange Commission, any securities self-regulatory organization, the appropriate enforcement authority or any state securities agency.

(D) Any registered person who has terminated association with a broker, dealer or municipal securities dealer and who has, within two years of the date of termination, become reassociated in a registered capacity with a broker, dealer or municipal securities dealer shall participate in the Regulatory Element at such intervals (two, five and 10 years) that may apply based on the initial registration anniversary date rather than based on the date of reassociation in a registered capacity.

(E) Definition of registered person — For purposes of this section, the term "registered person" means any person registered with the appropriate enforcement authority as a municipal securities representative, municipal securities principal, municipal securities sales principal or financial and operations principal pursuant to this rule.

(ii) Firm Element

(A) Persons Subject to the Firm Element — The requirements of this section shall apply to any person registered with a broker, dealer or municipal securities dealer who has direct contact with customers in the conduct of the broker, dealer or municipal securities dealer's securities sales, trading and investment banking activities, and to the immediate supervisors of such persons (collectively, "covered registered persons"). "Customer" shall mean any natural person and any organization, other than another broker, dealer or municipal securities dealer, executing securities transactions with or through or receiving investment banking services from a broker, dealer or municipal securities dealer.

(B) Standards for the Firm Element

(1) Each broker, dealer and municipal securities dealer must maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skill, and professionalism. At a minimum, each broker, dealer and municipal securities dealer shall at least annually evaluate and prioritize its training needs and develop a written training plan. The plan must take into consideration the broker, dealer and municipal securities dealer's size, organizational structure, and scope of business activities, as well as regulatory developments and the performance of covered registered

persons in the Regulatory Element.

(2) Minimum Standards for Training Programs — Programs used to implement a broker, dealer or municipal securities dealer's training plan must be appropriate for the business of the broker, dealer or municipal securities dealer and, at a minimum must cover the following matters concerning securities products, services and strategies offered by the broker, dealer or municipal securities dealer:

(a) General investment features and associated risk factors;

(b) Suitability and sales practice considerations;

(c) Applicable regulatory requirements.

(3) Administration of Continuing Education Program — A broker, dealer or municipal securities dealer must administer its continuing education programs in accordance with its annual evaluation and written plan and must maintain records documenting the content of the programs and completion of the programs by covered registered persons.

(C) Participation in the Firm Element — Covered registered persons included in a member's plan must take all appropriate and reasonable steps to participate in continuing education programs as required by the broker, dealer or municipal securities dealer.

(D) Specific Training Requirements — The appropriate enforcement authority may require a broker, dealer or municipal securities dealer, individually or as part of a larger group, to provide specific training to its covered registered persons in such areas the appropriate enforcement authority deems appropriate. Such a requirement may stipulate the class of covered registered persons for which it is applicable, the time period in which the requirement must be satisfied and, where appropriate, the actual training content.

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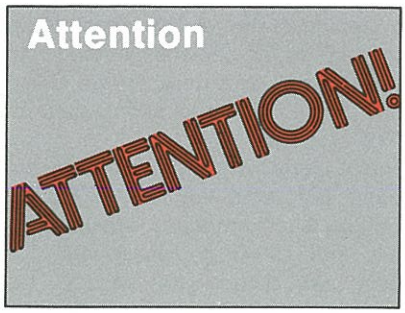
August 1994



Route to:

- ☒ Manager, Muni Dept.
- ☐ Underwriting
- ☐ Trading
- ☐ Sales
- ☐ Operations
- ☐ Public Finance
- ☒ Compliance
- ☒ Training
- ☐ Other

Status Report on the Continuing Education Program

Notice

This status report provides a review and summary of the proposed continuing education program. Questions and answers regarding the program also are provided.

Background

In March 1993, six self-regulatory organizations (SROs)[1] announced the formation of an industry task force to consider whether the industry should develop a uniform continuing education program for registered persons. The task force was composed of experienced individuals with diverse backgrounds from a broad range of firms, thus ensuring consideration of the interests and needs of a wide cross section of the industry. The SROs noted that the increasing complexity of the securities industry demands that professionals who deal with the public or are in supervisory positions maintain minimum standards of competence and professionalism. The SROs also said that a formal industry-wide continuing education program to keep professionals up to date on products, markets, and rules might be needed. By initiating a broad-based industry effort, the SROs hoped to provide a unified industry-wide approach acceptable to all segments of the industry.

In September 1993, the industry task force issued a report calling for a formal two-part continuing education program for securities industry professionals that would require uniform periodic training in regulatory matters (Regulatory Element) and ongoing programs by firms to keep employees up-to-date on job and product-related subjects (Firm Element). The report also recommended the creation of a permanent Industry/Regulatory Council on Continuing Education (the Council)[2] to recommend to the SROs the specific content of the uniform Regulatory Element and the minimum core curricula for ongoing firm training programs undertaken to satisfy the requirements of the Firm Element. The task force recommended further that computer-based training be used as a primary delivery vehicle for the uniform Regulatory Element of the program. In November 1993, the SROs endorsed in concept the recommendations of the industry task force.

Since November 1993, the Council has met monthly and has formed separate committees to work on the Regulatory and Firm Elements. The Regulatory and Firm Element Committees have prepared proposed draft rules that would implement the program when approved by the SROs. The Regulatory Element Committee has also developed an initial listing of standardized subject matter for the computer-based training program. The Firm Element Committee has developed standards that firms must adhere to in developing and implementing their training programs.

The Council has now submitted these proposed rules to the various SROs for review with an aggressive schedule to develop and implement the continuing education program.[3] The current target is to have the final rules adopted by the SROs by November 1994 and for the SROs to immediately thereafter file the rules for approval with the SEC. It is anticipated that the rules will be formally approved by the SEC in January 1995. The continuing education program would then be implemented on July 1, 1995.

Proposed Program Highlights

The Regulatory Element proposal requires all registered persons to participate in a prescribed computer-based training session on their second, fifth, and tenth registration anniversary dates. Persons who have been registered for more than 10 years and have not been the subject of a serious disciplinary action (as more fully described below) during the

Questions about this notice may be directed to Ronald W. Smith, Legal Associate, or Loretta J. Rollins, Professional Qualifications Administrator.

[1] The SROs include the American Stock Exchange (AMEX), the Chicago Board Options Exchange (CBOE), the Municipal Securities Rulemaking Board (MSRB), the National Association of Securities Dealers, Inc. (NASD), the New York Stock Exchange (NYSE), and the Philadelphia Stock Exchange (PHLX).

[2] The Council includes representatives from 13 broker/dealers and the six SROs. In addition, the Securities and Exchange Commission (SEC) and the North American Securities Administrators Association (NASAA) have each assigned a liaison to the Council. Members of the Council are listed at the end of this report.

[3] See the notice on the draft rule language for the continuing education requirement on pages 11 - 13 of this issue.

most recent 10 years are exempt from the Regulatory Element.

Failure to complete the required Regulatory Element computer-based training session during the prescribed period would result in a person's registration becoming inactive. A person whose registration becomes inactive cannot conduct a securities business or perform any of the functions of a registered person until such person meets the requirement.

Any person who would otherwise be exempt from the Regulatory Element would be required to re-enter the program for another 10 years upon becoming subject to certain disciplinary actions or as otherwise required by a securities regulatory or self-regulatory organization. Such re-entry would be occasioned by a person becoming subject to a statutory disqualification pursuant to the Securities Exchange Act of 1934; if an individual's registration is suspended by a securities regulatory or self-regulatory organization; or if a securities regulatory or self-regulatory authority imposes a fine of $5,000 or more for a violation of any securities law, rule, or regulation, which is the threshold level for determining a serious disciplinary action.

The Regulatory Element computer-based training program will be designed to transmit information broadly applicable to all registered persons. The content will be recommended by a group of industry representatives, subject to Council review and SRO approval. The content will focus on compliance, regulatory, ethical, and sales-practice standards. Because of the general and broadly applicable nature of this material, the Council determined to recommend that the Regulatory Element should be initiated with a "one size fits all" approach to the material to be transmitted in the computer-based training program, regardless of the job functions or registration status, such as Series 6 or Series 7.

While there will be no grading of individual performance on the Regulatory Element, information feedback will be provided to individuals and their firms regarding areas of apparent strength or weakness as indicated by the individual's interaction with the computer-based training program. In addition, aggregated information will be provided to firms on all their covered registered persons who take the computer-based training program in a given period. Firms will be expected to consider this information when formulating their training plans for the Firm Element, as more fully described below.

Unlike the Regulatory Element, where only those persons registered for 10 years or less are covered, the Firm Element has no time limitations. It is applicable to all persons who conduct business with retail, institutional, or investment banking customers of the firm. The immediate supervisors of such persons are also covered by the Firm Element.

The Firm Element requires each member to establish a training process and identifies certain minimum requirements associated with that process. The firm must prepare a training plan after an analysis of its training needs. Firms must consider certain factors when conducting their analyses and in developing their training plans, such as the firm's size, organizational structure, and scope of business activities, as well as regulatory developments and the performance of covered registered persons in the Regulatory Element. The program requires a training plan to be implemented by a member and requires the member to maintain records that clearly demonstrate the content of its training programs and the completion of the programs by the persons identified in the firm's training plan. Persons who are subject to the training plan would have an affirmative obligation to participate in the programs identified by the member.

The Firm Element also establishes certain minimum standards for the training programs that are used in a member's plan. For example, such programs, when dealing with investment products and services, must identify their investment features and associated risk factors, their suitability in various investment situations and applicable regulatory requirements that affect the products or services. The SROs would have the ability to require members, individually or as part of a group, to provide specific training to covered registered persons in any area the SROs deem necessary. Depending on the issue of concern, these requirements could be directed at specific individuals or portions of a firm, a specific firm or group of firms, or across the entire industry.

Implementation

The SROs propose to fully implement the Regulatory Element on July 1, 1995. The Central Registration Depository (CRD) system will track persons subject to the requirement and notify members in advance of those individuals approaching their second, fifth, and tenth year anniversary dates who are required to participate in a computer-based training session. Follow-up notices will also be sent as persons subject to the Regulatory Element requirement approach the end of the 120 days during which the requirement must be satisfied. In addition, the CRD system will generate monthly reports to members identifying those persons approaching or subject to the Regulatory Element requirement as well as those persons whose registrations have become inactive due to failure to complete the requirement within the specified time.

The Regulatory Element requirements will apply to all registered persons whose second, fifth, and tenth registration anniversary dates occur on or after July 1, 1995. Persons who have completed 10 years of registration before July 1, 1995, will be exempt. A person's registration anniversary dates will be measured from his or her first registration in the CRD, regardless of any subsequent firm changes or changes in registration category. Persons who have incurred a disciplinary event during the 10-year period before July 1, 1995, that would require them to re-enter the program will have an initial registration date that coincides with the effective date of the final decision in a disciplinary action.

The NASD PROCTOR system will be modified to handle the delivery of the computer-based training program in the 55-center PROCTOR network. Future expansion of the network is also being investigated, including the use of temporary centers that would operate periodically in areas located at a considerable distance from a full-time network center. In addition, the Council and the SROs will in the future consider the feasibility of permitting members to deliver the computer-based training on their internal computer systems if certain technical, administrative and regulatory concerns can be adequately resolved.

The Firm Element of the continuing education program will be implemented in two stages. By July 1, 1995, members

would be required to complete their training needs analyses and to develop written training plans that would be available for review upon request by the SROs, the SEC, and state regulators. Members would be expected to begin implementing their plans as soon as practicable but, in any event, no later than January 1, 1996. The SROs are committed to developing a consistent approach to examination and enforcement of the Firm Element requirements. Additionally, the SROs will coordinate their field inspection efforts to avoid any unnecessary regulatory overlap in the inspection process for firms that are joint members of two or more SROs.

The Firm Element provides great flexibility to firms in designing training programs appropriate to their needs and consistent with their resources, subject to broad standards defined in the Firm Element. The Firm Element framework is intended to be flexible enough to accommodate differences in the size, scope, and complexity of firm operations. Therefore, the Council and the SROs believe that the training needs analysis and training plan requirements of the proposal are within the capabilities of all organizations, regardless of size.

The Firm Element also proposes that a member would be responsible for assuring that training programs for investment products and services used in its training plan appropriately cover the investment characteristics and associated risk factors of the product or service, their suitability for different investment situations and any regulatory requirements that affect the product or service. The Council and the SROs realize that a great deal of the training material and programs will be provided by a variety of training and education providers. Nevertheless, the proposed rules place the responsibility on each member to assure that such training meets the broad content standards included in the rule as they relate to that particular firm. The SROs do not intend to pre-approve training materials and programs developed by members or providers. They will, however, communicate regularly with members regarding the expectations for the content of training programs. As the program evolves, it is expected some curricula content standards will be defined by the SROs for products and services where heightened regulatory concerns exist.

The Council intends to develop more extensive guidelines to assist firms in carrying out their responsibilities under the Firm Element and will recommend to the SROs that these guidelines be provided to firms when the final continuing education rules are adopted by the SROs and approved by the SEC.

August 1994

Industry/Regulatory Council on Continuing Education

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Questions and Answers Regarding the Securities Industry Continuing Education Proposals

1.

Q: What is the Industry/Regulatory Council on Continuing Education (the Council) and what role does it play?

A: The Council is comprised of 13 representatives of the securities industry (primarily the former members of the Securities Industry Task Force on Continuing Education) and representatives of six self-regulatory organizations (SROs). In addition, liaison personnel from the SEC and NASAA participate in Council meetings. The Council's role is to develop, update, and coordinate the Continuing Education program and to recommend specific content to the SROs for the Regulatory Element and minimum core curricula for the Firm Element.

In the future, industry representatives will be selected to serve three-year terms through a nominating-committee process designed to maintain representation of a broad cross section of industry firms. The Council will continue to evaluate the program and recommend changes to the SROs as necessary to ensure that the Regulatory and Firm Elements are responsive to industry needs and changes over time.

2.

Q: Why does the program consist of two elements?

A: The Regulatory Element is applicable to all persons registered with an SRO within their first 10 years in the business. Because the Regulatory Element is intended to enhance education and training in broad-based regulatory, compliance, and ethical issues, a "one size fits all" approach is initially contemplated for persons engaged in limited or full-service aspects of the securities business and in a variety of jobs.

The Firm Element is designed to ensure that firms provide ongoing education and training to persons who deal directly with individual, institutional, and investment banking customers. This element will focus on topics tailored specifically to the job functions and products handled by those people. Accordingly, the Firm Element has sufficient flexibility to meet the needs of all firms irrespective of their size or product mix.

3.

Q: Who will be covered by the program?

A: Every person registered for 10 years or less will be covered by the Regulatory Element and will be required to take the regulatory portions within 120 calendar days after their second, fifth, and tenth anniversaries.

The Firm Element requirements shall apply to all "covered registered persons" (salespeople, traders, investment bankers, and others who conduct a securities business with customers, and their first-line immediate supervisors) for as long as they are considered "covered registered persons." The term "customer" applies to retail, institutional, and investment banking customers, but does not include other broker/dealers.

4.

Q: Will registered personnel located outside the United States be covered?

A: Yes and the Council is considering what special accommodations may be necessary to deliver the program to such individuals.

5.

Q: Will anyone be grandfathered or exempted?

A: Grandfathering applies to the Regulatory Element only. Those who have been registered more than 10 years and who have not been the subject of a serious disciplinary action (suspension, bar, fine of $5,000 or more, or a statutory disqualification) during the most recent 10 years will be grandfathered from the Regulatory Element.

6.

Q: Are branch managers "covered registered persons" within the Firm Element?

A: Yes. Branch managers are covered registered persons because they directly supervise salespeople in the branch. If a branch manager also has customer accounts, then his/her supervisor is a "covered registered person" as well.

7.

Q: Are research analysts "covered registered persons" within the Firm Element?

A: Yes, if they communicate directly with or engage in sales presentations to customers.

8.

Q: Will either element contain pass/fail tests?

A: No. The Council recommended that the program should focus on increased education and training rather than on periodic examinations.

9.

Q: How will the program be administered?

A: The Regulatory Element will be delivered through computer-based training, in which participants will work through problems and/or scenarios at computer terminals located in an NASD PROCTOR center or other specified location.

The Firm Element will be delivered by firms and may include written materials, videos, audio tapes, classroom training, direct broadcasts, or other media.

10.

Q: What is the rationale behind discontinuing the Regulatory Element after 10 years?

A: Because information to be transmitted through the Regulatory Element is primarily of a compliance, regulatory, and ethical nature, it was perceived that individuals registered for more than 10 years without a significant disciplinary action would have adequately absorbed this material and that this would be reflected in their manner of doing business. In addition, all registered individuals who are "covered registered persons" will continue to be subject to the requirements of the Firm Element throughout their careers.

11.

Q: In the Regulatory Element, will there be a way to verify that individuals have completed the computer-based training?

A: Yes. The CRD system will track and communicate anniversary dates and evidence of completion for the Regulatory Element. The computer-based systems used to transmit the training information can also capture, store, and analyze data as to who took the training, when, where, and other information—in a manner similar to that of the industry qualification testing now conducted through the NASD PROCTOR system.

12.

Q: What is the expected fee for each Regulatory Element session at an NASD PROCTOR center?

A: The current estimate is about $75; however, the ultimate fee will depend on the overall costs for the program, which will operate on a revenue-neutral basis and be subject to periodic independent audits.

13.

Q: For those firms with internal computer systems and the capability to interface with the NASD PROCTOR system, will there be an opportunity to deliver the Regulatory Element material through these systems?

A: Initial delivery of the Regulatory Element will be on the PROCTOR system; however, the potential for internal delivery on firm computer systems is under discussion. Obviously, arrangements to permit internal delivery depend on the development of appropriate safeguards to ensure the integrity of the program and the ability to capture the necessary information for feedback.

14.

Q: Is the content of the Firm Element left entirely up to the individual firms?

A: No. The firms will be required to update training plans annually to demonstrate that they meet certain prescribed minimum standards with respect to subject material to be disseminated to their "covered registered persons" based on their needs, products, and lines of business.

15.

Q: Will "covered registered persons" need to participate in formal Firm Element training programs every year?

A: Not necessarily. There are no set schedules or required number of hours for the Firm Element, but coverage must be sufficient to meet the criteria established by SRO rules. For example, it may not be necessary to include every "covered registered person" within each calendar year if the firm is engaged exclusively in limited lines of business.

16.

Q: Is the annual compliance meeting required under Section 27 of the NASD Rules of Fair Practice adequate to demonstrate compliance with the requirements of the Firm Element?

A: Not in and of itself. It can certainly be used as an occasion on which to transmit information or conduct training. However, firms must address their own needs with regard to sales practices and product training and carry out effective programs. In most instances, a significant expansion of material covered at the annual compliance meeting will probably be necessary. Also, it may be appropriate to transmit some material in a more timely manner than waiting for scheduled annual compliance meetings.

17.

Q: Can the requirements of the Firm Element be met through continuation of the significant internal training and education programs already in place at some firms?

A: Possibly. For firms with comprehensive ongoing training programs in place, the requirements may result primarily in expanded record keeping, more formalized planning, and the incorporation of any minimum criteria specified by the SROs. It is likely, however, that most firms will need to substantially increase their education and training efforts to meet or exceed these requirements.

18.

Q: Will it be necessary for each "covered registered

person" to meet personally with his/her supervisor annually to determine the training requirement for that person?

A: No. However, some firms may elect to conduct such meetings to ascertain individual needs or to do so during regular performance reviews.

19.

Q: Can firms use training materials or presentations prepared or delivered by outside entities to satisfy the requirements of the Firm Element?

A: Yes, provided that they meet the same standards established for firms.

20.

Q: If firms use materials or presentations prepared or delivered by outside entities to satisfy the requirements of the Firm Element, who is responsible for the content?

A: Individual firms have the ultimate responsibility for the content and adequacy of material or presentations, regardless of who prepares or presents the material.

21.

Q: How can firms obtain guidance on designing and implementing internal training programs adequate to meet the requirements of the Firm Element?

A: The Council anticipates producing a compilation of guidelines taking into account comments and questions received while rule enactment is pending. These guidelines would not be rules but would offer suggestions intended to help firms devise appropriate and reasonable programs consistent with their own unique characteristics and businesses.

22.

Q: Will sessions devoted exclusively to selling skills or prospecting fulfill the requirements of the Firm Element?

A: No.

23.

Q: How will materials or presentations used by firms to satisfy the Firm Element be checked or evaluated?

A: Training plans, materials, outlines, and other required documentation must be retained for regulatory examination (upon request or during routine sales practices examinations) for conformance with standards prescribed by SRO rules. In addition, firms will be required to maintain evidence of participation and completion by their "covered registered persons."

24.

Q: What authority does the Council have to require firms to transmit specific information or carry out training in specific areas?

A: None directly. Explicit authority for the requirements and enforcement of the continuing education program will be established in rules promulgated by the SROs.

25.

Q: If a "covered registered person" has an insurance license and fulfills insurance continuing education obligations, can that serve as a substitute for the Firm Element?

A: Perhaps it may comprise a portion of the Firm Element requirements relating to insurance-related securities products, but it is unlikely that most insurance programs will meet all minimum standards prescribed under this program.

26.

Q: Will study materials be available?

A: A content outline will be prepared for the Regulatory Element. Guidelines will be published for the Firm Element and it is anticipated that additional study materials will be developed and made available by individual firms, product originators, and other outside entities.

27.

Q: When will the Continuing Education rules be enacted?

A: It is expected that the rules will receive SEC approval in January 1995.

28.

Q: When will the Regulatory Element actually go into effect?

A: The Regulatory Element is slated to begin on July 1, 1995. Thus, persons with two-, five-, and 10-year registration anniversaries on or after July 1, 1995 will be required to participate in accordance with those dates.

29.

Q: When and how will the Firm Element become effective?

A: The Firm Element will also begin on July 1, 1995, and, for most firms, will necessitate a two-tier implementation process. Firms will be required to have completed their written training plans by July 1, 1995. The Council and the SROs recognize that firms will likely require additional time to develop and prepare materials, plan budgeting needs, and arrange scheduling; however, the actual implementation of the plan must begin no later than January 1, 1996.

It is anticipated that regulatory examination for Firm Element compliance will also proceed in accordance with the preceding schedule. For example, written training plans are subject to inspection by July 1, 1995, and firm records should demonstrate programs in progress as of January 1, 1996.

30.

Q: How will people be phased into the program initially?

A: Individuals will be phased into the Regulatory Element based on their registration date or, if applicable, based on the date of the most recent disciplinary action against them. For example, persons who became registered in October 1990 would enter the program having been registered for more than four years and would first be required to participate in the

Regulatory Element around October 1995 (within 120 calendar days after their fifth anniversary of continuous registration). In October 2000 they would again participate to complete their 10-year cycle. Thereafter, they will be exempted from the Regulatory Element, provided they have no serious disciplinary action within the most recent 10-year period.

The Firm Element will begin for all "covered registered persons" no later than January 1, 1996, in accordance with their firms' written plans.

31.

Q: How does a serious disciplinary action affect one's status in the Regulatory Element?

A: A serious disciplinary action would effectively pre-empt one's original registration date as a trigger for entry into the full 10-year cycle of the Regulatory Element. Within 120 days of imposition of the disciplinary action, that individual will be required to participate in a Regulatory Element session, followed by additional sessions at the second, fifth, and tenth anniversaries of the date of the disciplinary action.

32.

Q: Is a serious disciplinary action the only factor that might mandate re-entry into the Regulatory Element?

A: No. A federal or state regulatory authority or self-regulatory organization may require re-entry into the Regulatory Element as part of a sanction in a disciplinary matter.

33.

Q: How will the registration date be calculated for individuals who have acquired multiple registrations (For example: The Series 6 in 1988 plus the Series 7 in 1991)?

A: The original registration date (1988 in the above example) will be used, provided that the person has remained continuously registered since that time.

34.

Q: How will temporary lapses in registration be handled?

A: These will be treated similar to the way in which qualification testing is handled. If individuals become unregistered for less than two years, they will maintain their original registration date, but will first be required to participate in any Regulatory Element program that may have been missed during the period in which they were unregistered. For example, an individual whose registration lapses at four and a half years who wishes to reactivate at what would be his/her six-year anniversary must complete the fifth year Regulatory Element before reactivation of registration.

35.

Q: What will be the status of a person who becomes unregistered for a two-year period or more?

A: This person would begin the entire registration process anew. He or she would be required to take the appropriate qualification examination(s) and would enter the Regulatory Element at the beginning of its 10-year cycle.

36.

Q: What regulatory consequences will result when an individual does not complete the required continuing education?

A: Non-compliance with Regulatory Element requirements will result in an individual's registration being deemed inactive until he/she fulfills all applicable elements. Firms must ensure that those deemed inactive are not permitted to engage in activities requiring registration. Failure to comply with Firm or Regulatory Element requirements may subject the firm and individuals to disciplinary action.

37.

Q: Will firms that are members of two or more SROs be subject to redundant inspections for compliance with the continuing education requirements?

A: The SROs will coordinate their field inspection efforts to avoid any unnecessary regulatory overlap for joint members. The SROs are especially committed to developing a consistent approach to examining for and enforcing the Firm Element requirements.

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MSRB REPORTS

August 1994

Notice of Approval

Route to:

- ☒ Manager, Muni Dept.
- ☒ Underwriting
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- ☐ Operations
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- ☐ Training
- ☐ Other

Political Contributions and Prohibition on Municipal Securities Business: Rule G-37

Amendments Approved

The Securities and Exchange Commission has approved amendments to rule G-37 on political contributions and prohibitions on municipal securities business, and rule G-8 on recordkeeping.

On June 3, 1994, the Securities and Exchange Commission (Commission) approved amendments to rule G-37 on political contributions and prohibitions on municipal securities business, and rule G-8 on recordkeeping: (i) to establish a procedure whereby dealers may seek relief from the rule G-37 prohibition on business, in limited circumstances; and (ii) to clarify certain definitions in rule G-37.[1] The amendments became effective upon approval by the Commission.

Summary of Amendments

A registered securities association or appropriate regulatory agency may exempt a dealer who is prohibited from engaging in municipal securities business with an issuer from such prohibition.

A number of commentators on rule G-37 expressed concern that imposing a prohibition on municipal securities business may be unfair in certain limited situations when political contributions have been made. For example, a disgruntled municipal finance professional may make a contribution purposely to injure the dealer, its management or employees. Also, a municipal finance professional eligible to vote for an issuer official may make a number of small contributions during an election cycle (*e.g.*, over four years) which, when consolidated, amount to slightly over the $250 *de minimis* exemption (*e.g.*, $255). In both examples, the contributions would trigger the prohibition on business under rule G-37(b), thereby prohibiting the dealer from engaging in municipal securities business with the issuer for two years.

The Board recognizes that in certain circumstances, such as those discussed above, the rule's prohibition on business may be too harsh a consequence for truly inadvertent contributions or the contributions of disgruntled employees. Thus, the Board determined to add new paragraph (i) to rule G-37 to establish a procedure whereby the National Association of Securities Dealers (NASD) and the federal bank regulatory agencies (*i.e.*, the Office of Comptroller of the Currency, Federal Reserve Board, and Federal Deposit Insurance Corporation), upon application by a dealer subject to such association's or agency's inspection and enforcement authority, may exempt, conditionally or unconditionally, a dealer who is prohibited from engaging in municipal securities business from such prohibition.[2] In determining whether to grant such an exemption, the amendments require that the NASD and bank regulatory agencies consider, among other factors, whether:

> (i) such exemption is consistent with the public interest, the protection of investors and the purposes of this rule; and
>
> (ii) such dealer (A) prior to the time the contribution(s) which resulted in such prohibition was made, had developed and instituted procedures reasonably designed to ensure compliance with this rule; (B) prior to or at the time the contribution(s) which resulted in such prohibition was made, had no actual knowledge of the contribution(s); (C) has taken all available steps to cause the person or persons involved in making the contribution(s) which resulted in such prohibition to obtain a return of the contribution(s); and (D) has taken such other remedial or preventive measures as may be appropriate under the circumstances.

The Board believes that a dealer that is subject to the prohibition on business should have to make a substantial effort to be exempted from that prohibition. The amendments require the dealer to petition the NASD or appropriate bank regulatory agency to seek such an exemption and to provide sufficient evidence to justify an exemption. In making a

Questions about the amendments may be directed to Diane G. Klinke, General Counsel, Jill C. Finder, Assistant General Counsel, or Ronald W. Smith, Legal Associate.

[1] SEC Release No. 34-34160.

[2] The NASD and the bank regulatory agencies are statutorily authorized to inspect for compliance with, and enforce, Board rules.

determination concerning an exemption, the NASD or appropriate bank regulatory agency would then review the facts and circumstances presented by the dealer, as well as the factors set forth in the amendments. The Board expects that this prohibition exemption not be routinely requested by dealers and be granted by the NASD and the federal bank regulatory agencies only in limited circumstances. The Board believes that the amendments will offer relief from the prohibition on business in appropriate circumstances without sacrificing the rule's purpose and intent, *i.e.*, to ensure that the high standards and integrity of the municipal securities industry are maintained, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to perfect a free and open market and to protect investors and the public interest. The Board will seek information from the NASD and bank regulatory agencies regarding the granting of any exemptions in order to monitor the implementation of this provision, and to determine if any changes are necessary.

Definition of "official of an issuer."

An "official of an issuer" is defined in rule G-37(g)(vi) as any incumbent, candidate or successful candidate for elective office of the issuer, which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a dealer for municipal securities business. The definition is intended to include any state or local official or candidate (or successful candidate) who has influence over the awarding of municipal securities business, including certain state-wide executive or legislative officials. The Board, however, was concerned that because the definition focuses on "an elective office of the issuer," it did not clearly include certain other officials. For example, a state may have certain issuing authorities whose boards of directors are appointed by the governor. Although the governor is an official with influence over the awarding of municipal securities business, the governor, in this illustration, is not an incumbent or candidate for "elective office of the issuer" (*i.e.*, the state authority). Thus, a contribution to the governor would not prohibit a dealer from engaging in business with the state authority. The Board intended to include the governor as an official of the issuer in such circumstances and, therefore, determined to amend the definition to clarify its intent. The amended definition of official of an issuer includes any incumbent or candidate "for any elective office of a state or of any political subdivision, which office has authority to appoint any official(s) of an issuer, as defined in [paragraph (g)(vii)(A) of rule G-37]."

Definition of "municipal securities business" does not include competitive financial advisory activities.

The definition of "municipal securities business" in rule G-37(g)(vii) includes certain dealer activities, such as acting as negotiated underwriters, financial advisors and consultants, placement agents, and negotiated remarketing agents. In its rule G-37 filing with the Commission, the Board noted that the rule would not prohibit dealers from acting as competitive underwriters or competitive remarketing agents.[3] The Board amended this definition to clarify that the rule also would not prohibit dealers from engaging in competitive financial advisory activities.

Only associated persons come under the definition of "municipal finance professional."

The Board determined to amend the definition of "municipal finance professional," as set forth in rule G-37(g)(iv), to clarify that only associated persons would fall within the rule's four categories of municipal finance professional.

Dealers shall send G-37 Reports to the Board by certified or registered mail or by some other means that provides a record of sending.

Rule G-37(e)(i) currently requires dealers to submit quarterly reports to the Board on Form G-37 concerning political contributions and municipal securities business. The Board is concerned, however, that some confusion could arise over whether particular reports were actually sent and/or lost in the mail. To obviate any such problem, the Board amended this paragraph to require that dealers send such reports to the Board "by certified or registered mail, or some other equally prompt means that provides a record of sending." This will ensure that dealers have a record of all reports submitted to the Board.[4]

The Board also amended this paragraph to correct an erroneous cross-reference to rule G-8, which requires dealers to submit to the Board reports on contributions that are required to be recorded pursuant to rule G-8(a)(xvi).

The rule requires, among other things, that dealers disclose the name, company, role and compensation arrangement of any person, other than a municipal finance professional, employed by the dealer to obtain or retain business.

Paragraph (e)(ii) of rule G-37 requires that the reports referred to in paragraph (e)(i) must include, among other things, a list of issuers with which the dealer has engaged in municipal securities business, along with the type of municipal securities business and the name, company, role and compensation arrangement of any person employed by the dealer to obtain or retain municipal securities business with such issuers. The Board intended that this provision apply to persons such as outside consultants, not municipal finance professionals. Thus, the amendment clarifies that this requirement does not require the dealer to disclose the name of any municipal finance professional hired by the dealer to obtain or retain municipal securities business.

Dealers complying with SEC Rule 17a-3 must maintain the information and records required by Board rule G-37.

Board rule G-8(f) allows dealers, other than bank dealers,

[3] File No. SR-MSRB-94-2 at 9, note 2.

[4] The Board previously addressed this issue in connection with rule G-36, concerning submission of official statements and advance refunding documents to the Board. That rule also requires dealers to send information to the Board via certified or registered mail, or some other equally prompt means that provides a record of sending.

who are in compliance with SEC Rule 17a-3, on recordkeeping, to be deemed in compliance with Board rule G-8, on recordkeeping. However, the rule provides that specific information required by rule G-8 must be maintained, even though such information is not required by SEC Rule 17a-3. The Board amended rule G-8(f) to clarify that dealers complying with SEC Rule 17a-3 are still required to maintain the information and records required by Board rule G-37.[5]

June 3, 1994

Text of Amendments*

Rule G-37. Political Contributions and Prohibitions on Municipal Securities Business

(a) - (d) No change.

(e)(i) Each broker, dealer or municipal securities dealer shall submit to the Board by certified or registered mail, or some other equally prompt means that provides a record of sending, and the Board shall make public, reports on contributions to officials of issuers and political parties of states and political subdivisions that are required to be recorded pursuant to rule G-8(a)~~(xiv)~~(xvi). Such reports shall include information concerning the amount of contributions made by: (A) the broker, dealer or municipal securities dealer; (B) all municipal finance professionals; (C) all executive officers; and (D) all political action committees controlled by the broker, dealer or municipal securities dealer or by any municipal finance professional. Such reports also shall include information on municipal securities business engaged in and certain other information specified in this section (e), as well as other identifying information as may be determined by the Board from time to time in accordance with Board rule G-37 filing procedures.

(ii) Reports referred to in paragraph (i) of this section (e) must be submitted to the Board on Form G-37, in accordance with Board rule G-37 filing procedures, quarterly with due dates determined by the Board, and must include, in the prescribed format, by state, the following information on contributions made and municipal securities business engaged in during the reporting period: (A) name, title (including any city/county/state or political subdivision) of each official of an issuer and political party receiving contributions; (B) total number and dollar amount of contributions made by the persons and entities described in paragraph (i) of this section (e); and (C) such other identifying information required by Form G-37. Such reports also must include a list of issuers with which the broker, dealer or municipal securities dealer has engaged in municipal securities business, along with the type of municipal securities business and the name, company, role and compensation arrangement of any person, other than a municipal finance professional, employed by the broker, dealer or municipal securities dealer to obtain or retain municipal securities business with such issuers.

(f) No change.

(g) Definitions.

(i) - (iii) No change.

(iv) The term "municipal finance professional" means: (A) any associated person primarily engaged in municipal securities representative activities, as defined in rule G-3(a)(i); (B) any associated person who solicits municipal securities business, as defined in paragraph (vii); (C) any associated person who is a direct supervisor of such persons up through and including, in the case of a broker, dealer or municipal securities dealer other than a bank dealer, the Chief Executive Officer or similarly situated official and, in the case of a bank dealer, the officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal securities dealer activities, as required pursuant to rule G-1(a); or (D) any associated person who is a member of the broker, dealer or municipal securities dealer (or, in the case of a bank dealer, the separately identifiable department or division of the bank, as defined in rule G-1) executive or management committee or similarly situated officials, if any.

(v) No change.

(vi) The term "official of such issuer" or "official of an issuer" means any person (including any election committee for such person) who was, at the time of the contribution, an incumbent, candidate or successful candidate: (A) for elective office of the issuer ~~(including any election committee for such person)~~ which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for municipal securities business by the issuer; or (B) for any elective office of a state or of any political subdivision, which office has authority to appoint any official(s) of an issuer, as defined in subparagraph (A), above.

(vii) The term "municipal securities business" means:

(A) - (B) No change.

(C) the provision of financial advisory or consultant services to or on behalf of an issuer with respect to a primary offering of municipal securities on other than a competitive bid basis; or

(D) No change.

(h) No change.

(i) A registered securities association with respect to a broker, dealer or municipal securities dealer who is a member of such association, or the appropriate regulatory agency as defined in Section 3(a)(34) of the Act with respect to any other broker, dealer or municipal securities dealer, upon application, may exempt, conditionally or unconditionally, a broker, dealer or municipal securities dealer who is prohibited from engaging in

[5] In addition, the Board amended rule G-8(f) to include appropriate cross-references to rules G-27 on supervision, and G-36 on delivery to the Board of official statements and advance refunding documents. This amendment clarifies that dealers complying with SEC Rule 17a-3 must still maintain the information and records required by rules G-27 and G-36. These cross-references were inadvertently omitted when the Board previously amended these rules.

* Underlining indicates additions; strikethrough denotes deletions.

municipal securities business with an issuer pursuant to paragraph (b) of this rule from such prohibition. In determining whether to grant such exemption, the registered securities association or appropriate regulatory agency shall consider, among other factors, whether:

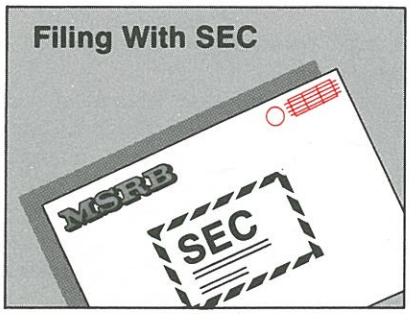
(i) such exemption is consistent with the public interest, the protection of investors and the purposes of this rule; and

(ii) such broker, dealer or municipal securities dealer (A) prior to the time the contribution(s) which resulted in such prohibition was made, had developed and instituted procedures reasonably designed to ensure compliance with this rule; (B) prior to or at the time the contribution(s) which resulted in such prohibition was made, had no actual knowledge of the contribution(s); (C) has taken all available steps to cause the person or persons involved in making the contribution(s) which resulted in such prohibition to obtain a return of the contribution(s); and (D) has taken such other remedial or preventive measures, as may be appropriate under the circumstances.

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

(a) - (e) No change.

(f) Compliance with Rule 17a-3. ~~Municipal securities b~~Brokers, dealers and municipal securities dealers other than bank dealers which are in compliance with rule 17a-3 of the Commission will be deemed to be in compliance with the requirements of this rule, provided that the information required by subparagraph (a)(iv)(D) of this rule as it relates to uncompleted transactions involving customers; paragraph (a)(viii); paragraph (a)(xi); paragraph (a)(xii); ~~and~~ paragraph (a)(xiii)~~,~~; paragraph (a)(xiv); paragraph (a)(xv); and paragraph (a)(xvi) shall in any event be maintained.



Route to:

- ☒ Manager, Muni Dept.
- ☒ Underwriting
- ☐ Trading
- ☐ Sales
- ☐ Operations
- ☒ Public Finance
- ☒ Compliance
- ☐ Training
- ☐ Other

Political Contributions and Prohibitions on Municipal Securities Business: Rule G-37

Amendments Filed and Additional Question and Answer Notice Published

The Board has filed amendments to rule G-37 on political contributions and prohibitions on municipal securities business, and rule G-8 on recordkeeping. The Board also has published a second Question and Answer notice concerning certain provisions of rule G-37.

On August 18, 1994, the Board filed with the Securities and Exchange Commission (Commission) amendments to rule G-37 on political contributions and prohibitions on municipal securities business, and rule G-8 on recordkeeping to clarify certain definitions as well as recordkeeping and reporting requirements.[1] The amendments will be effective upon approval by the Commission. In addition, the Board has published a Question and Answer notice regarding certain interpretive issues in rule G-37 that have been raised by dealers.

Background

Rule G-37, on political contributions and prohibitions on municipal securities business, was approved by the Commission on April 7, 1994.[2] On May 24, 1994, the Board published a Question and Answer (Q&A) notice in order to provide additional industry guidance concerning certain aspects of the rule. On June 3, 1994, the Commission approved amendments to the rule which (i) provide a procedure whereby dealers may seek relief from the rule's prohibition on business, in limited circumstances, and (ii) clarify certain definitions in the rule.[3] Notwithstanding these efforts, the Board is aware of continued industry concern over certain aspects of rule G-37. Thus, in an effort to ameliorate such concern, the Board has determined to amend the rule, as described below. In addition, the Board has published a second Q&A notice.

Summary of Amendments

Definition of Municipal Finance Professional

Primarily engaged in municipal securities representative activities

Rule G-37(g)(iv) provides that the term "municipal finance professional" means:

> (A) any associated person primarily engaged in municipal securities representative activities, as defined in rule G-3(a)(i);
> (B) any associated person who solicits municipal securities business, as defined in paragraph (vii);
> (C) any associated person who is a direct supervisor of such persons up through and including, in the case of a broker, dealer or municipal securities dealer other than a bank dealer, the Chief Executive Officer or similarly situated official and, in the case of a bank dealer, the officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal securities dealer activities, as required pursuant to rule G-1(a); or
> (D) any associated person who is a member of the broker, dealer or municipal securities dealer (or, in the case of a bank dealer, the separately identifiable department or division of the bank, as defined in rule G-1) executive or management committee or similarly situated officials, if any.
>
> Each person listed by the broker, dealer or municipal securities dealer as a municipal finance professional pursuant to rule G-8(a)(xvi) is deemed to be a municipal finance professional.

A number of dealers have expressed confusion over which retail sales persons fall within the definition of "municipal finance professional" based upon the municipal securities representative activities of such persons. Many of these dealers believe that such confusion arises from the fact that a

Questions about the proposed amendments may be directed to Diane G. Klinke, General Counsel, Jill C. Finder, Assistant General Counsel, or Ronald W. Smith, Legal Associate.

[1] File No. SR-MSRB-94-14. Comments submitted to the Commission should refer to this file number.
[2] SEC Release No. 34-33868. Pursuant to the Commission's order of approval, the rule became effective on April 25, 1994.
[3] SEC Release No. 34-34160. See the notice on pages 23 - 26 of this issue.

retail sales person's product mix can vary significantly, depending on the economy and customers' investment objectives. For example, a retail sales person's production over a particular quarter may include a preponderance of municipal securities transactions, whereas, in the next quarter, that same sales person's production may involve a preponderance of equity transactions. Such fluctuations in patterns of sales activity make it difficult for dealers to determine which retail sales persons are "primarily engaged in municipal securities representative activities."

In addition, rule G-37 requires a record to be made of all contributions by municipal finance professionals for the past two years.[4] Prohibitions on municipal securities business may result from such contributions. Thus, there is industry concern that a dealer employing hundreds or thousands of individuals who might become municipal finance professionals based on a percentage of sales of municipal securities during a certain period could find itself prospectively prohibited from engaging in certain municipal securities business, for up to two years, based on contributions from persons who were not municipal finance professionals when the contributions were made and who have little or no connection to the dealer's municipal securities business activities.

The Board noted in its initial filing of rule G-37 that the definition of municipal finance professional includes those individuals who have an economic interest in seeing that the dealer is awarded municipal securities business and thus may be in a position to make political contributions for the purpose of influencing the awarding of such business by issuer officials. Such persons would include those in the public finance department, as well as underwriters, traders and institutional and retail sales persons primarily engaged in municipal securities representative activities. The Board continues to believe that there may be limited instances in which retail sales persons make contributions for the purpose of influencing the awarding of municipal securities business. However, the Board is persuaded that, at this time, the rule currently imposes a compliance burden on dealers that is not outweighed by the benefit to be achieved by determining municipal finance professional status based upon the municipal securities representative activities of retail sales persons. Accordingly, the Board has determined to amend the definition of municipal finance professional in rule G-37(g)(iv)(A) by providing that sales activities with accounts, other than institutional accounts, shall not be considered to be municipal securities representative activities.[5] The amended definition of municipal finance professional still includes those persons in the public finance department, as well as underwriters, traders and institutional sales persons primarily engaged in municipal securities representative activities, but does not include retail sales persons. If, in the future, the Board learns of problems in connection with retail sales persons making contributions to influence the awarding of municipal securities business, then it will reconsider the propriety of exempting such persons from the definition of municipal finance professional.

A retail sales person, as well as any associated person, still could be designated a municipal finance professional under rule G-37(g)(iv)(B) if he or she solicits any municipal securities business. The Board notes that a dealer has an obligation to determine whether any of its associated persons (including retail sales persons) have solicited municipal securities business and, if so, to designate those persons as municipal finance professionals subject to rule G-37.

Supervisors of Municipal Finance Professionals

As noted previously, the definition of municipal finance professional includes any direct supervisor of a municipal finance professional up through and including, in the case of a broker, dealer or municipal securities dealer other than a bank dealer, the Chief Executive Officer or similarly situated official and, in the case of a bank dealer, the officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal securities dealer activities, as required pursuant to rule G-1(a). Some dealers have expressed concern that this part of the definition extends unnecessarily beyond the typical municipal department supervisors. For example, if someone from the corporate department assists the municipal department by soliciting work from a municipal issuer, such a person becomes a municipal finance professional because of these activities. Under the current rule, all direct corporate department supervisors of that individual also come under the definition of municipal finance professional, even though the person's municipal securities activities are subject to the supervision of a principal in the municipal securities department.

In an effort to facilitate compliance with rule G-37, the Board has determined to further amend the definition of municipal finance professional by designating as a municipal finance professional any associated person who is both (i) a municipal securities principal or a municipal securities sales principal and (ii) a supervisor of any person primarily engaged in municipal securities representative activities or who solicits municipal securities business. Thus, in the example given above, the corporate department supervisors would not be included in the definition of municipal finance professional. The Board wishes to note, however, that if a retail sales person solicits municipal business and thus becomes a municipal finance professional, then the municipal securities principal responsible for supervising that person's municipal securities activities (including any solicitation activities) would be designated a municipal finance professional. In most cases, this would include the sales person's branch manager (a municipal securities sales principal). The Board has decided to continue to include such supervisory personnel within the definition of municipal finance professional because it is concerned about situations in which retail sales persons are soliciting municipal securities business at the

[4] Pursuant to rule G-8(a)(xvi)(I), these recordkeeping requirements apply to contributions made on or after April 25, 1994.

[5] The term "institutional account" is defined in rule G-8(a)(xi) to mean the account of: (i) a bank, savings and loan association, insurance company, or registered investment company; (ii) an investment adviser registered under Section 203 of the Investment Advisers Act of 1940; or (iii) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million.

request of, or at least with the knowledge of, their supervisors. Thus, the Board wishes to ensure that, if retail sales persons are soliciting municipal securities business, the supervisors of such persons also are included within the definition of municipal finance professional.

Finally, the Board also has revised the definition of municipal finance professional to clarify that the supervisors of the municipal securities principals and municipal securities sales principals included within the definition also are considered municipal finance professionals.

Designation as a Municipal Finance Professional Extends for Two Years

The Board has been asked whether a dealer can establish its own standards under which someone who solicits municipal securities business could relinquish municipal finance professional status upon completing the solicitation activity. The Board has determined to further amend rule G-37(g)(iv) to provide that each person designated by a dealer as a municipal finance professional shall retain this designation for two years after the last activity or position which gave rise to the designation. For example, if an associated person is designated a municipal finance professional as a result of solicitation activities, then that designation shall extend for two years from the date of the particular solicitation. Moreover, if this person continues to solicit municipal business, then each such solicitation triggers a new two-year period. Thus, if a municipal finance professional wants to divest himself of this designation, he must forego all soliciting of municipal business for two years (as well as avoid the other situations, set forth in rule G-37(g)(iv), giving rise to the designation of municipal finance professional). So too, if an institutional sales person primarily engaged in municipal securities representative activities is transferred to the corporate department, such person's contributions to officials of issuers and payments to political parties must be recorded for two years after such transfer. The Board believes that this designation period extension will help to ensure that contributions and payments by municipal finance professionals are not being made to influence the awarding of municipal securities business. It also will allow dealers, after this two-year period, to remove these persons from their list of municipal finance professionals.

Contributions and Other Payments Made to Political Parties

Pursuant to rule G-37, contributions to political parties do not trigger the rule's prohibition on business. Such contributions, however, are subject to the rule's recordkeeping and reporting provisions, as set forth in rule G-8(a)(xvi). These disclosure requirements were adopted to help ensure that dealers are not circumventing the prohibition on business in the rule by indirect contributions to issuer officials through contributions to state or local political parties. For example, if a contribution to a political party is earmarked or known to be provided to a particular issuer official or officials, then the dealer would violate the rule's proscription against indirect violations, thereby triggering the two-year prohibition on business with that issuer.

In its rule G-37 filing with the Commission, the Board stated that it:

> has adopted . . . [rule G-37] as a first step toward eliminating the problems associated with political contributions in connection with the awarding of municipal securities business. It believes the rule is targeted to the reported major problem areas and should be an effective deterrent to activities which have called into question the integrity of the market. Once the proposed rule is put into place, the Board will closely monitor its effectiveness. If it determines that compliance problems exist, or if dealers seek to circumvent the proposed rule's requirements, the Board will not hesitate to amend the . . . rule to make its prohibitions applicable to a broader range of entities and individuals or to include other prohibitions or disclosure requirements.[6]

The Board has been notified by dealers and other industry participants that certain political parties currently are engaging in fundraising practices which, according to these political parties, do not invoke application of rule G-37. For example, some of these entities currently are urging dealers to make payments to political parties earmarked for expenses other than political contributions (such as administrative expenses or voter registration drives). Since these payments would not constitute "contributions" under the rule, the recordkeeping and reporting provisions would not apply.

The purpose of the disclosure requirements in rule G-37, with respect to political parties, is to ensure that funds contributed to political parties by dealers, Political Action Committees (PACs), municipal finance professionals and executive officers do not represent attempts to make indirect contributions to issuer officials, in contravention of the letter and the spirit of the rule. The Board continues to believe that disclosure is an adequate means of addressing this matter. However, the Board is concerned, based upon information provided by dealers and others, that the same pay-to-play pressures that motivated the Board to adopt rule G-37 may be emerging in connection with the fundraising practices of certain political parties, as described above. Accordingly, the Board has determined to amend the recordkeeping and reporting provisions of rule G-37 (as set forth in rule G-8(a)(xvi)) to require dealers to record and disclose all payments made to political parties. The term "payment" is defined as any gift, subscription, loan, advance or deposit of money or anything of value. This definition is derived from the definition of "contribution" in rule G-37(g)(i), but does not include the limits on the purposes for which such money is given, as currently set forth in the definition of contribution. Thus, as amended, the rule requires dealers to record and report any payments (including contributions) to political parties by dealers, PACs, municipal finance professionals and executive officers. The Board believes that these disclosure requirements will help to sever any connection between the giving of payments (including contributions) to political parties and the awarding of municipal securities business.

Finally, the Board does not seek, through its definition of

[6] File No. SR-MSRB-94-2 at 17.

payment, to restrict the personal volunteer work of municipal finance professionals for political parties.

Definition of Issuer

Under rule G-37, the term "issuer" is defined as any governmental issuer specified in Section 3(a)(29) of the Act (*i.e.*, a state or any political subdivision thereof, or any agency or instrumentality of a state or any political subdivision thereof, or any municipal corporate instrumentality of one or more states) and the issuer of any separate security, including a separate security as defined in Rule 3b-5 under the Act. This definition was taken from the SEC's definition of issuer in Rule 15c2-12. The Board has received a number of questions regarding the second portion of the definition—the issuer of a separate security. This portion of the definition was intended to include, for example, a municipality that signs a take-or-pay contract used as a guarantee of the underlying bonds. However, in most instances, the issuers of separate securities are corporate obligors of industrial revenue bonds and bank issuers of letters of credit.

Dealers have complained to the Board that the inclusion in the definition of the issuer of any separate security requires them to go through a "separate security" analysis to determine if a certain corporate obligor fits within this definition of issuer and then to determine if any personnel dealing with such issuers could be deemed municipal finance professionals. These determinations, however, do not result in any connection between the corporate issuers of separate securities and political contributions. In its May 1994 Q&A notice, the Board noted that, when filing Form G-37, dealers do not have to include corporate issuers in industrial development bond issues, since no contributions (as defined in rule G-37) would be made to such corporations.[7] As a result of these concerns, the Board has determined to amend the rule G-37 definition of issuer by omitting issuers of separate securities from the definition of issuer.

August 18, 1994

Text of Proposed Amendments*

Rule G-37. Political Contributions and Prohibitions on Municipal Securities Business

(a) - (d) No change.

(e)(i) Each broker, dealer or municipal securities dealer shall submit to the Board by certified or registered mail, or some other equally prompt means that provides a record of sending, and the Board shall make public, reports on contributions to officials of issuers and on payments to political parties of states and political subdivisions that are required to be recorded pursuant to rule G-8(a)(xvi). Such reports shall include information concerning the amount of contributions to officials of issuers and payments to political parties of states and political subdivisions made by: (A) the broker, dealer or municipal securities dealer; (B) all municipal finance professionals; (C) all executive officers; and (D) all political action committees controlled by the broker, dealer or municipal securities dealer or by any municipal finance professional. Such reports also shall include information on municipal securities business engaged in and certain other information specified in this section (e), as well as other identifying information as may be determined by the Board from time to time in accordance with Board rule G-37 filing procedures.

(ii) Reports referred to in paragraph (i) of this section (e) must be submitted to the Board on Form G-37, in accordance with Board rule G-37 filing procedures, quarterly with due dates determined by the Board, and must include, in the prescribed format, by state, the following information on contributions to each official of an issuer and payments to each political party of a state or political subdivision made and municipal securities business engaged in during the reporting period: (A) name~~,~~ and title (including any city/county/state or political subdivision) of each official of an issuer and political party receiving contributions or payments; (B) total number and dollar amount of contributions or payments made by the persons and entities described in paragraph (i) of this section (e); and (C) such other identifying information required by Form G-37. Such reports also must include a list of issuers with which the broker, dealer or municipal securities dealer has engaged in municipal securities business, along with the type of municipal securities business and the name, company, role and compensation arrangement of any person, other than a municipal finance professional, employed by the broker, dealer or municipal securities dealer to obtain or retain municipal securities business with such issuers.

(f) The Board will accept additional information related to contributions made to officials of issuers and payments to political parties of states and political subdivisions voluntarily submitted by brokers, dealers or municipal securities dealers or others provided that such information is submitted in accordance with Board rule G-37 filing procedures.

(g) Definitions.

(i) No change.

(ii) The term "issuer" means the governmental issuer specified in section 3(a)(29) of the Act ~~and the issuer of any separate security as defined in rule 3b-5 under the Act~~.

(iii) No change.

(iv) The term "municipal finance professional" means: (A) any associated person primarily engaged in municipal securities representative activities, as defined in rule G-3(a)(i); provided, however, that sales activities with accounts other than institutional accounts, as defined in

[7] Pursuant to rule G-37, a contribution is defined as "any gift, subscription, loan advance, or deposit of money or anything of value made: (A) for the purpose of influencing any election for federal, state or local office; (B) for payment of debt incurred in connection with any such election; or (C) for transition or inaugural expenses incurred by the successful candidate for state or local office." Thus, by definition, any funds given to corporate issuers would not constitute a "contribution," since such corporations are not the issuers or issuer officials contemplated by the rule.

* Underlining indicates new language; strikethrough denotes deletions.

rule G-8(a)(xi), shall not be considered to be municipal securities representative activities for purposes of this subparagraph (A); (B) any associated person who solicits municipal securities business, as defined in paragraph (vii); (C) any associated person who is both (i) a municipal securities principal or a municipal securities sales principal and (ii) a ~~direct~~ supervisor of ~~such~~ any persons described in subparagraphs (A) or (B); (D) any associated person who is a supervisor of any person described in subparagraph (C) up through and including, in the case of a broker, dealer or municipal securities dealer other than a bank dealer, the Chief Executive Officer or similarly situated official and, in the case of a bank dealer, the officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal securities dealer activities, as required pursuant to rule G-1(a); or ~~(D)~~ (E) any associated person who is a member of the broker, dealer or municipal securities dealer (or, in the case of a bank dealer, the separately identifiable department or division of the bank, as defined in rule G-1) executive or management committee or similarly situated officials, if any.

Each person ~~listed~~ designated by the broker, dealer or municipal securities dealer as a municipal finance professional pursuant to rule G-8(a)(xvi) is deemed to be a municipal finance professional. Each person designated a municipal finance professional shall retain this designation for two years after the last activity or position which gave rise to the designation.

(v) - (vii) No change.

(viii) The term "payment" means any gift, subscription, loan, advance, or deposit of money or anything of value.

(h)-(i) No change.

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

(a)(i) through (xv) No change.

(xvi) Records Concerning Political Contributions and Prohibitions on Municipal Securities Business Pursuant to Rule G-37. Records reflecting:

(A) - (D) No change.

(E) the contributions, direct or indirect, made to officials of an issuer and payments, direct or indirect, made to political parties of states and political subdivisions ~~made~~, by the broker, dealer or municipal securities dealer and each political action committee controlled by the broker, dealer or municipal securities dealer (or controlled by any municipal finance professional of such broker, dealer or municipal securities dealer) for the current year and separate listings for each of the previous two calendar years, which records shall include: (i) the identity of the contributors, (ii) the names~~,~~ and titles (including any city/county/state or other political subdivision) of the recipients of such contributions and payments, and (iii) the amounts and dates of such contributions and payments;

(F) No change.

(G) the ~~contributions~~ payments, direct or indirect, to political parties of states and political subdivisions made by all municipal finance professionals and executive officers for the current year and separate listings for each of the previous two calendar years, which records shall include: (i) the names, titles, city/county and state of residence of contributors, (ii) the names~~,~~ and titles (including any city/county/state or other political subdivision) of the recipients of such ~~contributions~~ payments and (iii) the amounts and dates of such ~~contributions~~ payments; provided, however, that such records need not reflect those ~~contributions~~ payments made by any municipal finance professional or executive officer to a political party of a state or political subdivision in which such persons are entitled to vote if the ~~contributions~~ payments by such person, in total, are not in excess of $250 per political party, per year.

(H) No change.

(I) No record is required by this paragraph (a)(xvi) of (i) any municipal securities business done or contribution to officials of issuers or political parties of states or political subdivisions made prior to April 25, 1994 or (ii) any payment to political parties of states or political subdivisions made prior to [the effective date of the amendment].

(b) - (f) No change.

* * * * *

Additional Rule G-37 Q&As

Contributions to Non-Dealer Associated or "Special Interest" PACs

1.

Q: Does rule G-37 address contributions to non-dealer associated or "special interest" PACs?

A: Rule G-37 does not deal directly with contributions to non-dealer associated or "special interest" PACs. Unless the non-dealer associated or "special interest" PAC solicits contributions for the purpose of supporting an issuer official, contributions to these PACs should not result in a ban on business under section (b) of rule G-37.

Refund of Inadvertent Contribution

2.

Q: A disgruntled municipal finance professional made a contribution purposely to subject the dealer to the two-year prohibition on business. When the contribution is discovered by the dealer, a refund of the contribution is requested and obtained. Is the dealer still banned from engaging in business with that issuer? In addition, does the contribution have to be disclosed on Form G-37?

A: Rule G-37(b) prohibits a dealer from engaging in municipal securities business with an issuer within two years after any contribution to an official of such issuer by any municipal finance professional associated with such dealer if

the contribution does not meet the *de minimis* exemption. Section (i) of the rule provides a procedure whereby dealers may seek relief from the appropriate enforcement agency of the rule G-37 prohibition on business, in limited circumstances. In determining whether to grant such an exemption, one of the factors the enforcement agency will consider is whether the dealer has taken all available steps to obtain a return of the contribution. Even if a refund of the contribution has been obtained, dealers are required to seek an exemption from the ban on business. In addition, dealers also must disclose the contribution on Form G-37. Dealers may wish to indicate on the form (and in their own records) that a refund of the contribution was obtained.

Dealer Resources

3.

Q: If an employee of a dealer is donating his or her time to an issuer official's campaign, does the dealer have to disclose this as a contribution to such official? In addition, would the fact that the employee is taking a leave of absence from the dealer cause a different result?

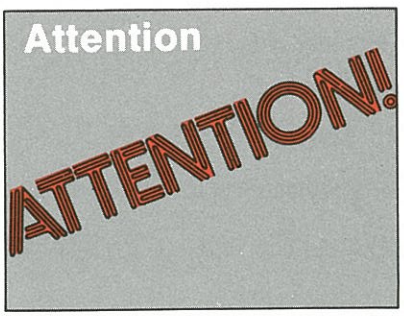
A: An employee of a dealer generally can donate his or her time to an issuer official's campaign without this being viewed as a contribution by the dealer to the official, as long as the employee is volunteering his or her time during non-work hours, or is using previously accrued vacation time or the dealer is not otherwise paying the employee's salary (*e.g.*, an unpaid leave of absence).

Executive Officers in Banks

4.

Q: In a bank with a separately identifiable dealer department, who would be considered an executive officer?

A: For most bank dealer departments which deal only in municipal securities, there are no individuals who meet the definition of executive officer within rule G-37.



Route to:

- ☒ Manager, Muni Dept.
- ☒ Underwriting
- ☐ Trading
- ☐ Sales
- ☐ Operations
- ☒ Public Finance
- ☒ Compliance
- ☐ Training
- ☐ Other

Instructions for Completing and Filing Form G-37

The purpose of these instructions is to assist dealers in submitting a complete and correct Form G-37. Rule G-37 requires dealers to submit to the Board certain summary information on their municipal securities business and contributions to issuer officials and political parties, by the dealer, municipal finance professionals, executive officers, and PACs controlled by dealers and municipal finance professionals. "Municipal securities business" is defined in rule G-37 to mean: (1) negotiated underwriting (if the dealer was a manager or syndicate member); (2) private placement; (3) financial advisor or consultant to an issuer (on a negotiated bid basis); and (4) remarketing agent (on a negotiated bid basis).

While voluntary information will be accepted, the Board wants to clarify the minimum required information. A review of the first set of Forms G-37 submitted, for the period of April 25, 1994 – June 30, 1994, has revealed some common areas of misunderstanding about the requested information on the form. This notice seeks to provide assistance in the completion of the forms for subsequent reporting periods.

It is important to note that Form G-37 must be submitted to the Board if one or both of the following occurred:

- **reportable political contributions were made during the reporting period;**
- **the dealer engaged in municipal securities business during the reporting period.**

Dealers are not required to submit a Form G-37 only if the dealer had no reportable political contributions and no municipal securities business was engaged in during the reporting period.

It is also important to note that two copies of Form G-37 must be submitted to the Board and at least one of those copies must contain an original signature.

Completing Form G-37

Name of Dealer and Report Period

The first line requires that you indicate the name of the dealer.

- It became apparent from the initial set of Forms G-37 filed that several dealers had not notified the Board of their name change. Rule A-15(c), on notification of name or address change, requires dealers to notify the Board promptly of any name or address change.

The second line requires that you list the quarterly period for the form you are submitting.

- Dealers must use the calendar quarters for the reporting period. It is not acceptable to create a different time period and submit information only pertaining to that time. For example, the initial Form G-37 submission must include data from April 25 to June 30, 1994. If a dealer included information to July 31, information on July 1-31 also must be included on the next report.

Contributions Made

Contributions required to be reported pursuant to rule G-37 must be listed by state.

Each official or state or local political party receiving the contribution should be listed separately, by state.

For each contribution, the total number and dollar amount of the contribution by the dealer, the dealer-controlled PAC and/or municipal finance professionals and executive officers should be listed.

- If no contributions were made, do not indicate the total number of municipal finance professionals and executive officers of the dealer.
- Rule G-37 does not require that dealers list the names of municipal finance professionals and executive officers on Form G-37.

• "Contribution" is a defined term in rule G-37(g)(i). Rule G-37 does not require dealers to list other gifts or gratuities on Form G-37.

If there were no contributions required to be reported pursuant to rule G-37 during the reporting period, please indicate "none."

Issuers with Which the Dealer Has Engaged in Municipal Securities Business and Any Other Person Employed By Dealer to Obtain or Retain Such Municipal Securities Business

(If no contributions were made during the reporting period, dealers are still required to submit a Form G-37 if they engaged in municipal securities business during the reporting period.)

List, by state, the complete name of the issuer and include the city and county of the issuer in which the dealer engaged in municipal securities business.

List the type of municipal securities business engaged in with that issuer. "Municipal securities business" is defined in rule G-37(g)(vii) to mean: (1) negotiated underwriting (if the dealer was a manager or syndicate member); (2) private placement; (3) financial advisor or consultant to an issuer (on a negotiated bid basis); and (4) remarketing agent (on a negotiated bid basis). In determining when to list municipal securities business, a guideline is:

• for negotiated underwritings, indicate the business at least by the settlement date if within the reporting period;

• for remarketing agent activities, indicate the business when there is an initial agreement—do not continue to list the remarketings;

• for financial advisory or consultant services, indicate the business when an agreement is reached to provide the services (rule G-23, on activities of financial advisors, requires dealers to have a written agreement with issuers);

• for private placements, indicate the business at least by the settlement date if within the reporting period.

Rule G-37 does not require dealers to indicate on Form G-37 the competitive business in which the dealers engaged.

Rule G-37 does not require dealers to indicate those negotiated underwritings in which dealers were selling group members.

List the name, company, role and compensation arrangement of any person employed by the dealer to obtain or retain such municipal securities business for the particular issue being listed.

• For the disclosure of persons employed to obtain or retain the municipal securities business concerning a particular issue, do not list municipal finance professionals employed by the dealer.

• List the dollar amount paid as the compensation arrangement of those persons employed by the dealer to obtain or retain the municipal securities business.

If the dealer did not engage in any municipal securities business during the reporting period, please indicate "none."

Signature, Date, Name, Address, Phone

An officer of the dealer must sign and date the form.

• An officer of the dealer refers to a corporate officer. The fact that someone is a compliance officer does not necessarily mean that person is a corporate officer.

• One of the two forms submitted to the Board must contain an original signature. Until at least one form with an original signature is received, the Board's records will not indicate that the dealer has complied with the rule's filing requirements.

Indicate the date the form was signed.

Indicate on the Name line, the name of the officer who signed the form.

Include the dealer's address and phone number.

Filing Procedures

Rule G-37 filing procedures require dealers to file **two copies** of Form G-37, and to submit such forms within 30 calendar days after the end of each calendar quarter. These filing dates are January 31, April 30, July 31 and October 31. The forms must be submitted by certified or registered mail or some other equally prompt means that provides the dealer with a record of sending. Submissions by fax will not be accepted.

Form G-37 is contained on the next page.

FORM G-37

NAME OF DEALER: _____

REPORT PERIOD: _____

CONTRIBUTIONS MADE: (LIST BY STATE)

STATE	COMPLETE NAME, TITLE (INCLUDING ANY CITY/COUNTY/STATE OR OTHER POLITICAL SUBDIVISION) OF OFFICIAL/POLITICAL PARTY	TOTAL NUMBER AND DOLLAR AMOUNT OF CONTRIBUTIONS; BY DEALER: BY PAC: BY *(ENTER NUMBER OF)* _____ MUNICIPAL FINANCE PROFESSIONALS AND EXECUTIVE OFFICERS:

ISSUERS WITH WHICH DEALER HAS ENGAGED IN MUNICIPAL SECURITIES BUSINESS AND, WHERE APPLICABLE, ANY OTHER PERSON EMPLOYED BY DEALER TO OBTAIN OR RETAIN SUCH MUNICIPAL SECURITIES BUSINESS: (LIST BY STATE)

STATE	COMPLETE NAME OF ISSUER AND CITY/COUNTY	TYPE OF MUNICIPAL SECURITIES BUSINESS	NAME, COMPANY, ROLE AND COMPENSATION ARRANGEMENT OF ANY PERSON EMPLOYED BY DEALER TO OBTAIN OR RETAIN SUCH MUNICIPAL SECURITIES BUSINESS

SIGNATURE: _____ DATE: _____

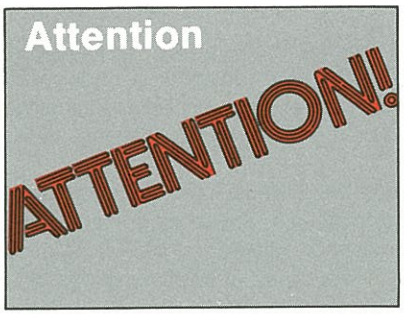
(MUST BE OFFICER OF DEALER)

NAME: _____

ADDRESS: _____

PHONE: _____

SUBMIT COMPLETED FORM QUARTERLY BY DUE DATE (SPECIFIED BY THE MSRB) TO MUNICIPAL SECURITIES RULEMAKING BOARD, 1640 KING STREET, SUITE 300, ALEXANDRIA, VIRGINIA 22314



Route to:

- ☒ Manager, Muni Dept.
- ☒ Underwriting
- ☒ Trading
- ☒ Sales
- ☐ Operations
- ☒ Public Finance
- ☒ Compliance
- ☐ Training
- ☐ Other

Board's Comment Letter on SEC Releases Concerning Municipal Securities Disclosure

The Board is reprinting its comment letter on two recent Securities and Exchange Commission releases concerning municipal securities disclosure.

August 3, 1994

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549

Re: **File No. S7-4-94** on Disclosure Obligations of Municipal Securities Issuers
File No. S7-5-94 on Proposed Amendments to Exchange Act Rule 15c2-12 on Municipal Securities Disclosure

Dear Mr. Katz:

The Municipal Securities Rulemaking Board ("Board") is the self-regulatory organization charged with responsibility of writing rules governing the municipal securities activities of brokers, dealers and municipal securities dealers ("dealers").[1] In the above-captioned matters, the Securities and Exchange Commission has asked for comments on a Release providing interpretive guidance on disclosure responsibilities in the municipal securities market (the "Interpretive Release")[2] and on proposed amendments to Exchange Act Rule 15c2-12 relating to continuing disclosure by municipal securities issuers and other matters (the "proposed amendments").[3] The Board appreciates the opportunity to comment on these important Commission initiatives.

BACKGROUND

The Commission first noted its intention to take action on continuing disclosure in a September 1993 Report of the Commission's Division of Market Regulation ("SEC Staff Report").[4] The SEC Staff Report described substantial benefits that would accrue to the market from an increased flow of continuing disclosure. It also stated that the Division of Market Regulation would recommend that the Commission provide interpretive guidance on municipal securities disclosure and that the Division would propose rules to prohibit the recommendation of outstanding municipal securities unless adequate issuer information is available.[5]

On October 13, 1993, Commission Chairman Levitt spoke on the topic of municipal securities disclosure to representatives of various industry groups at a meeting sponsored by the Board. Chairman Levitt asked those present to work together to formulate a workable plan for improving continuing disclosure. Members of several of these industry groups ultimately formed a working committee, which produced a December 1993 document for the Commission entitled "Joint Statement on Improvements in

[1] The Board was created by the Securities Acts Amendments of 1974, Pub. L. No. 94-29, 89 Stat. 131 (1975). The relevant provisions of this legislation are now codified in Section 15B of the Securities Exchange Act.
[2] Securities Exchange Act Release 33741 (March 9, 1994).
[3] Securities Exchange Act Release 33742 (March 9, 1994) [hereinafter cited as "Proposing Release"].
[4] Securities and Exchange Commission, Division of Market Regulation, *Staff Report on the Municipal Securities Market* (September 1993).
[5] *SEC Staff Report* at 40.

Municipal Securities Market Disclosure" ("Joint Statement").[6] The Joint Statement included recommendations for: (i) very general SEC interpretive guidance to issuers on their continuing disclosure responsibilities; (ii) an SEC rule conditioning underwritings upon the issuer's agreement to provide continuing disclosure; (iii) "suitability" obligations for dealers, keying on the continuing disclosure information available to dealers; and (iv) a distribution mechanism for disclosure documents utilizing multiple information repositories.

This general approach of the Joint Statement ultimately was incorporated in the Interpretive Release and in the proposed amendments. The Interpretive Release, for example, offers very general disclosure guidance to issuers, enunciating only the basic principles of antifraud liability. The proposed amendments would supplement this guidance by conditioning the underwriting of new issue municipal securities upon the issuer undertaking a contractual commitment to provide two types of continuing disclosure. First, the issuer must commit to provide timely notice of certain material events ("material events disclosure"). Second, the issuer must commit to provide other documents relating to the issuer's financial condition and operations encompassing, at a minimum, an annual audited financial statement ("periodic information"). To address the suitability of transactions, the proposed amendments would condition the recommending of securities in the secondary market upon the above disclosure documents having been prepared by issuers and reviewed by dealers. Finally, the proposed amendments would establish a distribution system for disclosure documents by ensuring that each document is sent to at least one "recognized repository," the requirements for which would be set by the Commission.

BOARD SUPPORT OF COMMISSION'S CONTINUING DISCLOSURE GOALS

The Board commends the Commission and the authors of the Joint Statement on their efforts to improve continuing disclosure in the municipal securities market. By encouraging groups of industry participants to work together to formulate proposals, the Commission can ensure that it receives recommendations reflecting the interests of each of the market segments represented. This process has helped the Commission to obtain relevant information and views on continuing disclosure, and, as discussed below, the Board believes that this process also may provide a means to address some of the more difficult challenges that remain ahead.

As the self-regulatory organization for municipal securities dealers, the Board has recognized the importance of continuing disclosure and has taken several steps to bring about improvements. For several years, the Board has emphasized the need to improve access to issuer information as a means to strengthen the market and to promote better compliance with the Board's customer protection rules.[7] In 1990, after obtaining comment from market participants, the Board filed with the Commission a plan for collecting and disseminating voluntarily provided continuing disclosure notices, which ultimately become the Continuing Disclosure Information Pilot ("CDI Pilot") system.[8] More recently, the Board has considered how it could bring about an increased flow of continuing disclosure documents for dissemination through the CDI Pilot system and through other channels. In August 1993, the Board announced a rulemaking initiative, including a confirmation disclosure requirement and other dealer mandates, to encourage the production of continuing disclosure documents.[9] After the September 1993 announcement of the Commission's intention to act in this area, the Board suspended its own efforts and offered its assistance to the Commission.[10]

The Board strongly supports the objectives of the Interpretive Release and proposed amendments and wishes to offer several suggestions on how these objectives can be met. In general, the Board believes that notices of material events are best collected and disseminated to electronic information vendors by a central facility such as the Board's CDI Pilot system. The Board believes that the Commission can and should act on material events disclosure by using the approach in the proposed amendments and the CDI Pilot system. With respect to periodic information, the Board believes that the Commission should continue, and perhaps formalize, its process of working with market participants in order to develop more detailed continuing disclosure standards. Specific standards for content, format and timing of continuing disclosure documents—even though the standards may be voluntary—would help to overcome many of the obstacles that the municipal market faces in implementing a comprehensive system for continuing disclosure. The Board's specific comments on the Interpretive Release and proposed amendments are provided below.

MATERIAL EVENTS DISCLOSURE

The proposed amendments would condition the underwriting of new issues upon a commitment by the issuer (and any "significant obligors") to provide timely notice of the occurrence of any one of 11 specified events, if the occurrence of such event

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[6] The Joint Statement was submitted by the American Bankers Association's Corporate Trust Committee, American Public Power Association, Association of Local Housing Finance Authorities, Government Finance Officers Association, National Association of Bond Lawyers, National Association of Counties, National Association of State Auditors, Comptrollers, and Treasurers, National Association of State Treasurers, National Council of State Housing Agencies, National Federation of Municipal Analysts and the Public Securities Association.

[7] *See, e.g.*, "From the Chairman," *MSRB Reports* Vol. 8. No. 5 (December 1988) at 2.

[8] SR-MSRB-90-4, filed June 22, 1990, approved as amended, Exchange Act Release No. 30556 (April 6, 1992) [hereinafter cited as "CDI Pilot System Filing Documents"]; *see also* text at notes 12-15, *infra*.

[9] *See* text at note 33, *infra*.

[10] *See* Letter dated October 7, 1993, from David C. Clapp, Chairman, and Charles W. Fish, Immediate Past Chairman, MSRB, to Arthur Levitt, Chairman, Securities and Exchange Commission [hereinafter cited as "October 1993 Letter to Commission"]. The Board, at that time, also had under consideration other efforts to promote voluntary use of the CDI Pilot system, including joint efforts with the Government Finance Officers Association, National Council of State Housing Agencies and the National Federation of Municipal Analysts. These efforts also were suspended pending the outcome of the Commission's proposal.

is "material." This provision is designed to provide the market with quick notice of events or conditions that might immediately affect the market price of securities. Accordingly, it appears that material events notices generally would tend to be short, time-critical notices, written specifically for the securities market.

The Board believes that the approach taken by the proposed amendments will work well for material events notices as long as efficient, timely and equal access to the notices can be assured.[11] For example, it is critical that at least one repository should have a comprehensive stream of material events notices. If this capability does not exist, market participants may be forced to subscribe to all repositories to ensure that they are informed of all material events—an inefficiency that would work against the purpose of the proposed amendments. In addition, because material events disclosure may affect the market price of securities very quickly, it is important that such notices be made available to all interested parties on a timely and equal basis.

The easiest and most workable method for addressing material events disclosure would be for the Commission to provide for a central facility to receive all material events notices and to ensure that this facility provides efficient, timely and equal access to all information vendors that wish to receive the documents. Information vendors can, in turn, quickly retransmit the notices to all interested parties in the market, through existing electronic information dissemination networks and through other mechanisms.

The CDI Pilot System

The CDI Pilot system has been designed from its inception to provide a central collection and dissemination point for short, time-critical disclosure documents such as material events notices. With respect to timely dissemination, the CDI Pilot system provides almost immediate, automated turn-around for documents submitted in electronic format and dissemination generally within 15 minutes for documents submitted by facsimile. Same-day dissemination is guaranteed for documents received by mail.[12] The CDI Pilot system has been specifically designed to ensure that all subscribers to the system are sent documents at exactly the same time. This is of particular importance to electronic information vendors who may be competing against each other in providing information to market participants. Finally, the Board ensures the CDI Pilot system is made available to any interested party on equal terms to avoid conferring any special or unfair benefit to specific vendors or other entities.

In operational experience, the CDI Pilot system has proven itself a reliable and cost-efficient mechanism for collecting and disseminating relatively short disclosure documents in a timely and fair manner. As of July 1994, 33 indenture trustees and 22 issuers have enrolled to provide the market with documents through the system. Since the system began operations in January 1993, over 1,300 documents have been disseminated. The system has experienced no substantial technical problem in receiving and transmitting documents within the stated turn-around parameters, either in operational experience[13] or under maximum capacity tests.[14]

As long as the documents submitted to the system are kept relatively short in length, the CDI Pilot system currently is capable of collecting and disseminating over one hundred disclosure documents each day. Since material events notices naturally will tend to be short documents, the Board believes that the CDI Pilot system would provide an excellent distribution mechanism for such notices. Of course, it is expected that certain adjustments might be necessary in the system to process a comprehensive stream of material events notices generated under the proposed amendments.[15] It appears, however, that such changes could be made in a relatively short period of time. If the Commission decides in favor of a central facility for collecting time-critical documents and disseminating them to information vendors, the Board offers the CDI Pilot system for this purpose.

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[11] While some of the 11 categories of events are fairly specific (*e.g.*, "unscheduled draws on reserve funds"), others are very general (*e.g.*, "matters affecting collateral"). The Interpretative Release provides relatively little guidance on what issuers should disclose or how or when disclosure should be made for the more general categories of events. Over time, it may be necessary for the Commission to provide additional guidance on these subjects. Nevertheless, the Board believes that the meaning and intent of the 11 stated categories of material events is clear and that it should not be necessary to delay implementation of the proposed amendments pending additional guidance.

[12] As initially proposed, the system plan called for information to be submitted and disseminated exclusively in electronic format, using personal computers and modems. This requirement was intended to allow an automatic turn-around of incoming documents to system subscribers. The Board's June 1990 filing of its plan with the Commission noted that, because of the efficiencies offered by electronic collection and dissemination of information, it would be possible to expand this system to include longer, more complex documents, such as financial statements. It was also noted that, to accomplish this goal, the producers of documents (*e.g.*, issuers and trustees) and the users of the system would have to agree upon a limited number of standardized electronic formats in which the longer documents would be submitted. *See* CDI Pilot System Filing Documents, *supra* note 8; *MSRB Reports* Vol. 10, No. 3 (July 1990) at 3-6.

In June 1991 the Commission suggested in an open meeting that the Board should not limit its system to electronic submission of documents. In October of that year, the Board filed an amended version of the system that allowed for the submission of paper documents and documents sent by facsimile transmission. In April 1992, the Commission approved the Board's plan for a pilot version of the system. Securities Exchange Act Release No. 30556 (April 6, 1992); *MSRB Reports* Vol. 12. No. 1 (April 1992) at 3-5. The CDI Pilot system became available for trustee submissions in January 1993 and for issuer submissions in May 1993. *MSRB Reports* Vol. 13, No. 1 (January 1993) at 3; *MSRB Reports* Vol. 13, No. 3 (June 1993) at 19.

[13] In actual operations, more than 90 percent of the notices received by the system have been early redemption notices and notices of advance refunding, with relatively few documents providing disclosure information relevant to valuing municipal securities. The Board believes that the small number of substantive disclosure notices primarily is related to issuer reluctance, for various reasons, to prepare market-oriented disclosure notices. The proposed amendments, of course, would overcome this problem.

[14] For example, in capacity testing, the average time necessary for the CDI Pilot system to process a document sent by facsimile transmission and to make it ready for re-transmission was 6.63 minutes.

[15] Potential changes include increased capacity to process documents slightly longer than the current three-page per document limit and increasing incoming and outgoing telephone and facsimile transmission lines for use by additional issuers, trustees and information vendors.

DISCLOSURE OF PERIODIC INFORMATION

Continuing disclosure documents other than short, time-critical notices of material events present a number of different issues for consideration. While the approach taken by the proposed amendments for periodic disclosure is an excellent starting point for discussion, the Board believes that more work will be needed before a comprehensive system for periodic information can be implemented. For the reasons noted below, the Board believes that the Commission should exclude periodic information from the scope of the proposed amendments until certain practical difficulties can be addressed.

Need for Additional Standards on Content, Format and Timing of Periodic Information

Over 70,000 state and local governments, political subdivisions, authorities and other types of issuers today produce a broad variety of documents containing information potentially relevant to the value of outstanding municipal securities.[16] These documents are prepared to serve various purposes under many different state laws and regulations.[17] With the exception of official statements and the Consolidated Annual Financial Reports prepared by some issuers, the documents generally are not prepared specifically for the securities markets and there tends to be little consistency in the content, format and timing of the documents. As a result, the information included in these documents is not readily accessible to the securities market and, all too often, is not used in evaluation of secondary market securities.

The Board believes that additional standardization will be necessary before any system for periodic disclosures can produce net benefits for the municipal securities market. Several factors lead to this conclusion. First, to avoid confusion and inconsistencies, issuers must understand clearly what information they should disclose and when to disclose it.[18] Second, if disclosure documents are to be used efficiently in evaluating securities, market participants will need to rely upon the existence of market-oriented standards that outline what information will be provided and where it will be found in the disclosure documents. Third, any distribution system that is to convey periodic information efficiently from issuers to market participants will need document standards to ensure that it is not overwhelmed with multi-use documents that are of marginal utility to the securities market.

The very general guidance given concerning periodic disclosure documents in the Interpretive Release and proposed amendments[19] contrasts sharply with the very detailed requirements in the corporate securities markets.[20] The Board, of course, recognizes that the unique and diverse nature of the municipal securities market does not lend itself to the same type of standards that may be applicable to profit-oriented corporate ventures. The Board also recognizes that a Commission rule or Commission interpretation of the antifraud provisions of the Securities Exchange Act may not be the appropriate vehicle for providing detailed guidance on municipal disclosure documents. Nevertheless, the Board believes that additional standardization of disclosure documents is necessary for meaningful progress to occur in dissemination of useful continuing disclosure to the market.

Possible Role for Voluntary Continuing Disclosure Standards

Over recent years, the Board has strongly and publicly encouraged the ongoing efforts of industry organizations to establish voluntary standards for continuing disclosure. There have been a number of these projects, including those undertaken by the Government Finance Officers Association ("GFOA") the National Federation of Municipal Analysts ("NFMA"), the Corporate Trust Committee of the American Bankers Association ("ABA") and the National Association of State Housing Agencies.[21]

As noted by the Commission, the several efforts made thus far on voluntary continuing disclosure guidelines have not yet achieved general industry acceptance.[22] In the past, however, the Commission has used its considerable resources to gather relevant industry parties and to create a consensus on necessary industry standards. An example is the Commission's 1986 Release supporting specific, detailed voluntary procedures for call notification.[23] These guidelines were formed by market participants, with the assistance and participation of Commission staff. Although voluntary, the guidelines, with the Commission's support, have become industry standards and have served to alleviate many of the problems associated with inadequate notice of early redemptions.

The Board believes that the cooperative efforts of the authors of the Joint Statement provide an excellent starting point for the development of more detailed continuing disclosure guidelines that could be endorsed by the Commission. With the Commission's

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[16] In addition, the non-governmental "significant obligors" referenced in the proposed amendment also produce a variety of financial and operational reports.

[17] *See generally* National Association of State Auditors Comptrollers and Treasurers, *Report of the Blue Ribbon Committee on Secondary Market Disclosure* (August 1993).

[18] As already has been indicated by published reports, issuers will be inclined to have different interpretations of general requirements for annual information and material events disclosure. *See, e.g.*, "Issuers to SEC: What Exactly Do You Want Us to Disclose?," *The Bond Buyer*, June 6, 1994, p. 8A. Moreover, issuers and significant obligors with weaker credit quality may be the ones most likely to take a narrow view of what is required for periodic information.

[19] The proposed amendments, for example, anticipate that an issuer could provide periodic information through "any disclosure document, whatever its form or principal purpose." It also is noted that such documents could be provided at any time during the year. Proposing Release, *supra* note 3, at 9.

[20] Detailed requirements for content, format, and timing of disclosure documents are found in Regulation S-K and Forms 10-K, 10-Q and 8-K.

[21] In many cases, the Board has published its letters of support. *See, e.g.*, *MSRB Reports* Vol. 9, No. 2 (August 1989) at 27 (ABA Guidelines for trustees); *MSRB Reports* Vol. 10, No. 4 (October 1990) at 19-20 (GFOA Disclosure Guidelines); *MSRB Reports* Vol. 9, No. 2 (October 1990) at 29-30 (NFMA Disclosure Guidelines).

[22] Interpretive Release at 28.

[23] Exchange Act Release No. 23856 (December 3, 1986). Commission staff hosted a meeting of industry participants to agree on these standards on November 14, 1986.

support and participation, it is likely that quick progress could be made in developing voluntary standards for content, format and timing of periodic information.

Distribution System for Periodic Information

Without standardized, market-oriented disclosure documents, many issuers might choose to supply repositories with any and all documents containing potentially relevant information. As suggested above, this could result in a flood of long, marginally useful documents to the "recognized repositories" contemplated under the proposed amendments.[24] Assuming a heavy flow of such documents, it seems doubtful that repositories could meet the one-day turnaround and electronic dissemination capabilities suggested for periodic disclosures[25]—at least not in a cost-effective manner.[26] Market-oriented document standards would minimize this problem and allow repositories and information vendors to locate, process and disseminate the specific information that is needed to evaluate secondary market securities.[27]

If multiple repositories are used for periodic information, the Board believes that a mechanism will be needed to track all documents in the repository system. As currently drafted, the proposed amendments provide an incentive for all information vendors to become recognized repositories so that they can be designated to receive disclosure documents from issuers. This likely would lead to the existence of many recognized repositories, none of which would have a comprehensive collection of documents. Without a central tracking mechanism, market participants and information vendors would be forced to subscribe to all recognized repositories to ensure that they are notified as soon as documents of interest are received by a repository. As noted in its October 7, 1993, letter to the Commission, the Board believes its Municipal Securities Information Library™ system could be modified to provide this central tracking function, although building this capability would require a substantial lead time.[28]

In addition to a central tracking function, the Board believes that the Commission should also consider policies regarding fair access to periodic information documents at multiple repositories. For example, the Commission may wish to require recognized repositories to share documents with each other. This would allow comprehensive collections of documents to be built by several repositories and obviate the need for market participants and information vendors to link with all repositories to obtain needed documents. Given that repositories often will be competitors in the electronic dissemination of information, the Commission may wish to consider policies, procedures and monitoring techniques to ensure that repositories provide fair access to documents to all parties, including their competitors in the information market.

The timing of document availability also should be considered. Even though several repositories ultimately may have comprehensive collections of continuing disclosure documents, regulatory questions are created when one repository obtains a critical document prior to other repositories. If dealers are considered responsible for the document when the first repository receives it and makes it available, it may be necessary for dealers to have access to all repositories to ensure that they can obtain timely information about the securities they are trading.[29] While this may be less of a concern for periodic information than for material events disclosure, it is likely to create problems and confusion as to dealer responsibilities if not directly addressed by the Commission.

Dealer Review of Periodic Disclosure

The Board supports the Commission's objective in requiring dealer review of periodic information prior to recommending securities in the secondary market. The Board repeatedly has emphasized that continuing disclosure information is necessary for dealers to meet the investor protection standards imposed by Board investor protection rules.[30] These rules require dealers: to disclose the material facts of a transaction to the customer (rule G-17); to ensure that any transaction recommended to the customer is suitable for that customer (rule G-19); and, to ensure that the prices set for customer transactions are fair and

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[24] Without some guidance on preparation of documents designed specifically for market participants, issuers could flood repositories with all manner of documents—from political speeches to thousand-page reports having only tangential relevance to the issuer's credit quality.

[25] Proposing Release, *supra* note 3, at 21.

[26] The problems associated with quickly processing and disseminating non-standardized paper documents in a cost-effective manner were fully described in a 1991 letter to the Commission. Letter dated July 3, 1991, from Christopher A. Taylor, Executive Director, MSRB, to William H. Heyman, Director, Division of Market Regulation, Securities and Exchange Commission.

[27] To ensure that this is the case, it may be advisable to include potential repositories and information vendors in any cooperative industry effort intended to arrive at continuing disclosure standards. With specific reference to cost-efficiency and same-day electronic dissemination of periodic information, such a group might also explore whether standards could be set for submission of documents in electronic formats. This idea previously has been explored by the Board in connection with the CDI Pilot system. See note 12, *supra*.

[28] The tracking function would entail a centralized, electronically accessible record of facts such as: (i) whether a disclosure commitment has been undertaken by an issuer with respect to an issue; (ii) when periodic disclosures are due at a repository; (iii) a record of the disclosure documents that have been provided by the issuer to any repository (including description and dates); and (iv) the location where those documents can be found. Building this capability in the current system would depend upon the cooperation of a number of parties and would require specific action by the Commission to ensure that tracking data is communicated to the Board in an accurate and timely manner. *See* October 1993 Letter to Commission, *supra* note 10. In addition, it should be noted that the tracking function by itself would not address the concern of one repository obtaining a crucial document prior to other repositories, or the potential need for dealers to subscribe to all repositories to ensure timely access to documents.

[29] *See* Letter of December 20, 1993, from Christopher A. Taylor, Executive Director, MSRB, to Catherine McGuire, Associate Director, Office of Chief Counsel, Division of Market Regulation, Securities and Exchange Commission.

[30] *See, e.g.*, CDI Pilot System Filing Documents, *supra* note 8.

reasonable (rule G-30). If a dealer is not aware of major financial and other material developments affecting an issuer's securities, it is difficult or impossible for the dealer to comply with these requirements. Once such information is accessible through a repository, however, it is clear that the dealer is responsible for the information. The Board emphasizes that, in its view, dealers would be responsible for continuing disclosure information available in recognized repositories even without the specific "review" requirement in the proposed amendments.

Under current conditions, the Board does not believe that a requirement to review "complete" periodic information is a practical option for dealers. Periodic information is so voluminous that it simply would not be possible for dealers to quickly obtain and review such information through electronic information vendors, as has been suggested.[31] Requiring review of lengthy periodic information documents prior to all recommendations of secondary market securities would severely limit the liquidity of many issues and tend to harm the current investors much more than it would protect potential investors.

The formation of industry standards for continuing disclosure documents would facilitate easier and more meaningful dealer review of periodic information, but would not provide a complete solution to this problem. The Board believes Commission and cooperative industry effort should be directed toward looking at other mechanisms to ensure that the information necessary for suitability determinations—as well as the information necessary for compliance with other Board investor protection rules—reaches the hands of dealers. Some concepts that might be pursued include: (i) standards for summary information that could be reviewed by dealers and provided to customers; (ii) the role of credit ratings and the existence of a current investment grade credit rating as a possible substitute for the review requirement; and (iii) the possibility of targeting the review requirement only on those types of issues that have historically evidenced a potential for default.[32]

Board's August 1993 Proposal

The Commission might also wish to consider whether aspects of the Board's August 1993 proposal on continuing disclosure could be used as a substitute for the approach taken by the proposed amendments with respect to periodic information.[33] The August 1993 proposal was based upon the Board's observations that issuers were not always aware of the importance of continuing disclosure and that underwriters often did not make any recommendation to issuers concerning the market's need for continuing disclosure. The Board also noted that market forces were not distinguishing in price between those issuers providing continuing disclosure and those that were not.

In response to this situation, the Board proposed to adopt rules to require underwriters to explain to issuers the significance of continuing disclosure and to require underwriters to recommend that a specific commitment be undertaken by the issuer to supply continuing disclosure to the marketplace. The Board also proposed to require dealers to disclose to customers, and to include on confirmations, information on whether the issuer had made such a commitment and to require dealers to disclose to customers, and include on confirmations, the negative effects on the marketability of a security if continuing disclosure is not being provided. By requiring specific disclosures to customers and clearly identifying those issues without continuing disclosure commitments, the Board hoped to assist market forces in producing a meaningful price distinction between issues with continuing disclosure commitments and those having none.

Assuming that substantive continuing disclosure standards can be developed by a cooperative industry effort, the Board's August 1993 proposal could be used to support those standards. For example, the Board could adopt rules requiring underwriters to explain to issuers the importance of meeting specific, Commission-endorsed disclosure standards and rules requiring dealer disclosure to customers of issues that are not in conformance therewith. This approach—based upon the customer's right to know if an issue meets accepted industry disclosure standards—would promote issuer conformance with standards and would provide protection for investors through required disclosure. At the same time, it would avoid several of the problems discussed above with respect to the application of the proposed amendments to periodic information.

CONCLUSION

The Board is hopeful that, under the Commission's guidance, additional progress can be made in providing the market with the continuing disclosure that it needs. The Board looks forward to working with the Commission on this matter and offers its support and assistance in developing and implementing a framework for reaching the Commission's objectives.

Sincerely,

David C. Clapp
Chairman

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[31] The proposed amendments contemplate that information can be reviewed via electronic information vendors as long as it is "complete." Proposing Release, *supra* note 3, at 12 n. 19. As a practical matter it is not possible for the millions of pages of financial data, as might exist in annual reports for 70,000 issuers, to be converted from paper to electronic form and be made available overnight to dealers.

[32] The Interpretive Release notes that health care issues, housing issues, industrial development bonds, and other conduit financings may fit into this category. Interpretive Release, at 9.

[33] *See MSRB Reports* Vol. 13, No. 4 (August 1993) at 3-4.

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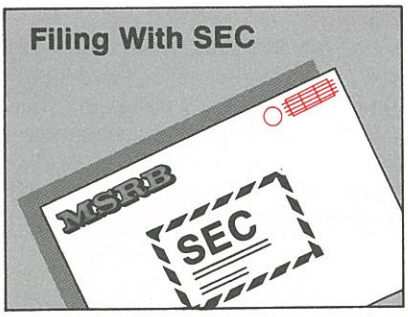

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Requiring Underwriters to Apply for Depository Eligibility of New Issues: Rule G-34

Amendment Filed

The Board has filed an amendment to rule G-34 that requires dealers to apply for depository eligibility within one business day of the date of sale of a new issue municipal security. The proposed amendment exempts (i) issues not meeting the eligibility criteria of the depository and (ii) issues maturing in 60 days or less from its requirements. It also provides a temporary exemption until July 1, 1996, for issues under $1 million in par value.

On August 17, 1994, the Board filed with the Securities and Exchange Commission (Commission) an amendment to rule G-34, on CUSIP numbers and dissemination of initial trade date information, concerning depository eligibility of new issue municipal securities.[1] The proposed amendment requires that brokers, dealers and municipal securities dealers (dealers) apply for depository eligibility within one business day of the date of sale of a new issue municipal security. The proposed amendment exempts (i) issues not meeting the eligibility criteria of the depository and (ii) issues maturing in 60 days or less from its requirements. It also provides a temporary exemption until July 1, 1996, for issues under $1 million in par value. The Board has requested that the amendment be given an effective date 60 days after approval by the Commission to allow dealers to adjust their underwriting procedures to obtain compliance.

Background

In October 1993, the Commission approved Exchange Act Rule 15c6-1, which compresses the current five-day regular-way settlement cycle to three days (T+3 settlement).[2] Although municipal securities were not included within the scope of Rule 15c6-1, the Commission requested that the Board provide a plan for converting the municipal securities market to T+3 settlement to maintain consistency with other securities markets.

In March 1994, the Board provided the Commission with its *Report of the Municipal Securities Rulemaking Board on T+3 Settlement for the Municipal Securities Market* (*T+3 Report*).[3] The *T+3 Report* detailed changes in operational practices and regulatory actions that would be needed in a T+3 environment for municipal securities.

One area in which the Board believes that change is needed concerns the use of physical securities certificates to settle inter-dealer and institutional customer transactions. Because these transactions are settled on a Delivery vs. Payment or Receipt vs. Payment (DVP/RVP) basis, it is critical that the delivery of securities be made in a timely manner on settlement date. However, the physical delivery of certificates is a relatively time-consuming and inefficient practice, as compared to book-entry delivery through a securities depository. A shortened settlement cycle will provide dealers, institutional customers and their clearing agents with considerably less time to deal with the processing requirements and inevitable problems that arise in connection with transportation, delivery and acceptance of physical securities certificates. In many situations, it may be difficult or impossible to deliver securities certificates within three days to accomplish a DVP/RVP settlement. Therefore, the Board believes that the conversion to T+3 settlement would be facilitated if the practice of delivering physical certificates to settle inter-dealer and institutional customer transactions is discouraged in favor of book-entry settlement.

In 1993, the Board amended rules G-12(f)(ii) and G-15(d)(iii) to require essentially all inter-dealer and institutional customer transactions to be settled by book-entry when the securities involved in the transaction are listed as eligible for deposit in a depository. While these rules have assisted the municipal securities industry in moving toward more universal use of book-entry settlement, the rules apply only to transactions in securities that are depository-eligible.

Summary of Comments and Discussion

In March 1994, the Board requested comment on a draft

Questions about the proposed amendment may be directed to Judith A. Somerville, Uniform Practice Specialist.

[1] File No. SR-MSRB-94-13. Comments submitted to the Commission should refer to the file number.
[2] *See* Securities Exchange Act Release No. 34-33023 (October 6, 1993).
[3] *See MSRB Reports*, Vol. 14, No. 2 (March 1994) at 5-14.

amendment to rule G-34 that would require dealers to apply for depository eligibility of all new issue municipal securities.[4] The draft amendment included exemptions for issues not meeting the criteria set by depositories for eligibility and new issues under $1 million in par value. The Board received ten comments in response to its request. While the comments were generally supportive, some commentators suggested modifications in the draft amendments. The Board has adopted some of these suggestions.

10-Day Application Period

The draft amendment would have required dealers to apply to a depository at least 10 days prior to the closing date of a new issue to establish depository eligibility. This provision was intended to support the routine practice recommended by depositories, even though depositories can and do make new issues eligible on shorter notice when this is necessary. A majority of commentators, however, believe that the 10-day application period is inappropriate for a Board rule, in light of the need of underwriters occasionally to settle a new issue with an issuer on short notice. Three commentators, including the Public Securities Association (PSA) and the Securities Industry Association (SIA), proposed a different approach, which would tie the application requirement to the date of sale, rather than the date of closing. These commentators suggested that the provision be changed to require the application to be made within 24 hours of the award of an issue.

The Board notes that this suggestion would avoid potential problems that might occur in the occasional cases in which there is less than 10 days between the date of award of an issue and the settlement of the issue. At the same time, the requirement for underwriters to apply to a depository one day after the date of sale gives depositories the maximum amount of time available to establish eligibility and prepare for a book-entry distribution. Therefore, the Board has revised the draft amendment to state that the application must be made within one business day of the date of sale of the issue.[5] The proposed amendment now also includes a requirement that, if the full documentation and information required to establish depository eligibility is not available from the underwriter at the time the initial application is submitted to the depository, the underwriter shall forward such documentation to the depository as soon as it is available.

Exemption for Issues Under $1 Million in Par Value

The draft amendment included exemptive language for issues under $1 million in par value because of concerns that had been expressed by some dealers relating to small issues with limited distribution. Eight commentators urged the Board to include issues under $1 million in par value within the rule, most citing the need for increased settlement efficiencies when T+3 becomes effective. Two commentators suggested a temporary exemption for small issues, and noted that, ultimately, all issues should be included within the scope of the rule, but that some underwriters of small issues may need time to adjust their procedures associated with clearance and settlement of small issues. The Board believes that this is a reasonable approach and has adopted a provision in the draft amendment that would exempt issues under $1 million in par value until July 1, 1996.

Exemption for Issues Maturing in 60 Days or Less

Three commentators suggested an exemption for issues maturing in 60 days or less, noting that these issues typically do not trade in the secondary market. The Board is not aware of any substantial trading in such short-term securities and agrees that an exemption for issues maturing in 60 days or less would be appropriate. The exemption accordingly has been included within the draft amendment.

Depository Eligibility Criteria

The Board understands that, of the three depositories accepting municipal securities for deposit, the eligibility criteria is essentially the same and that nearly all municipal securities meet the criteria for depository eligibility. If, however, an issue could not be made eligible at any of these depositories, the proposed amendment would not require the underwriter to make an application.[6] One commentator urged that depositories reach agreement on uniform minimum guidelines to minimize the burden on underwriters and inefficiencies that might be caused by any differing eligibility criteria among the depositories. While the Board agrees with this goal, the Board does not have regulatory authority over depositories. The Board will continue to monitor any problems created by differing eligibility criteria and may suggest remedial actions to the Commission in the future if differing eligibility criteria create problems under the proposed amendment.

August 17, 1994

Text of Proposed Amendment*

Rule G-34. CUSIP Numbers, ~~and~~ Dissemination of Initial Trade Date Information and Depository Eligibility

(a) New Issue Securities.

(i)-(ii) No change.

(iii) Application for Depository Eligibility.

(A) Except as otherwise provided in this subparagraph (iii), each broker, dealer or municipal securities dealer who acquires, whether as principal or agent, a new issue of municipal securities from the issuer of such securities for the purpose of distributing such new issue shall apply to a securities depository registered with the Securities and

[4] *See* "Requiring Underwriters to Apply for Depository Eligibility of New Issues: Rule G-34," *MSRB Reports*, Vol. 14, No. 2 (March 1994) at 15-18.

[5] For competitively sold issues, the date of award from the issuer is considered the date of sale. For negotiated issues, the date of execution of the contract to purchase the securities from the issuer is considered the date of sale.

[6] The exception in the draft amendment for new issues that do not meet a depository's eligibility criteria is necessary because the terms of a new issue ultimately are controlled by the issuer of the securities, which is not subject to Board rules.

* Underlining indicates new language; strikethrough denotes deletions.

Exchange Commission, in accordance with the rules and procedures of such depository, to make such new issue depository-eligible. The application required by this subparagraph (A) shall be made as promptly as possible, but in no event later than one business day after award from the issuer (in the case of a competitive sale) or one business day after the execution of the contract to purchase the securities from the issuer (in the case of a negotiated sale). In the event that the full documentation and information required to establish depository eligibility is not available at the time the initial application is submitted to the depository, the broker, dealer or municipal securities dealer shall forward such documentation as soon as it is available.

(B) Subparagraph (iii)(A) of this rule shall not apply to an issue of municipal securities that fails to meet the criteria for depository eligibility at all depositories that accept municipal securities for deposit.

(C) Subparagraph (iii)(A) of this rule shall not apply to any new issue maturing in 60 days or less.

(D) Subparagraph (iii)(A) of this rule, shall not apply to any new issue that is less than $1 million in par value, *provided however,* that this exemption shall expire July 1, 1996.

(iv) Underwriting Syndicate. In the event a syndicate or similar account has been formed for the purchase of a new issue of municipal securities, the managing underwriter shall take the actions required under the provisions of this rule.

(b)-(c) No Change.

(d) CUSIP Number Eligibility. The provisions of this rule shall not apply to an issue of municipal securities (or for the purposes of section (b) any part of an outstanding maturity of an issue) which does not meet the eligibility criteria for CUSIP number assignment.

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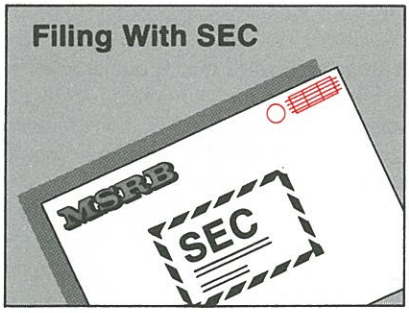

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Underwriting Assessment: Rule A-13

Amendment Filed

The Board has filed an amendment to rule A-13 with the Securities and Exchange Commission that would prohibit dealers from charging or otherwise passing through to issuers the fees required under that rule.

To provide revenues for its operation and administration, the Board imposes three types of fees on brokers, dealers and municipal securities dealers (dealers). The Board charges an initial fee of $100 and an annual fee of $100 under rules A-12 and A-14, respectively. In addition, Board rule A-13 requires dealers to pay fees to the Board based upon the dealers' individual participation in primary offerings of municipal securities (rule A-13 fees). Rule A-13 fees provide the bulk of Board revenues.

On August 15, 1994, the Board filed with the Securities and Exchange Commission an amendment to rule A-13 stating that dealers may not charge or otherwise pass through rule A-13 fees to issuers.[1] The purpose of the amendment is to clarify that these fees are dealer assessments that should be considered as part of a dealer's "overhead" costs of operation—just as the annual and initial fees of rules A-12 and A-14. An A-13 fee therefore may not be charged to an issuer by the dealer as expense of bringing a specific new issue to market. The Board has requested that the amendment become effective 30 days after approval by the Commission.

Rule A-13

Rule A-13 requires each dealer to pay to the Board a fee based upon the dealer's participation in "primary offerings" of municipal securities.[2] The amount of rule A-13 fees owed is based upon the par value of the dealer's participation in primary offerings.[3] No obligation to pay a rule A-13 fee is generated by participation in the following types of primary offerings: (i) those composed exclusively of securities less than nine months in maturity; (ii) offerings under $1 million in par value; and (iii) "limited placement" offerings, as described in subsection (c)(1) of Exchange Act Rule 15c2-12.[4]

Rule A-13 states that, if a syndicate or similar account is formed for the purpose of purchasing securities from an issuer, the managing underwriter is responsible to pay the assessment fee on behalf of each participant in the syndicate. Payment by the managing underwriter, rather than by individual syndicate members, is solely an administrative convenience for underwriters and the Board. The Board invoices managing underwriters monthly for rule A-13 fees, based upon information filed with the Board under rule G-36 on delivery of official statements to the Board.

Rule A-13 is intended to provide a dealer assessment that roughly reflects each dealer's involvement in the municipal securities market. In adopting rule A-13 in 1976, the Board recognized that participation in new issue offerings was not a perfect means to measure a dealer's involvement in the market because the assessment would not, among other things, reflect secondary market transactions and activity.[5]

Questions about the proposed amendment may be directed to Christopher A. Taylor, Executive Director.

[1] File No. SR-MSRB-94-12. Comments on the draft amendment should be provided to the Commission and should refer to this number.

[2] As used in rule A-13, "primary offering" is defined as in Exchange Act Rule 15c2-12 on municipal securities disclosure. Thus, a dealer's obligation under rule A-13 is triggered by its participation in the offering of municipal securities by or on behalf of an issuer, whether the dealer is purchasing the securities directly (*i.e.*, is acting as underwriter) or is acting as an agent in placing the securities with investors. The obligation of a dealer to deliver an official statement to the Board under Board rule G-36 also is based upon the dealer's participation in a "primary offering." Consistent use of the concept of "primary offering" in rules A-13 and G-36 has created substantial administrative efficiencies for the Board by allowing A-13 fee invoicing to be accomplished in an automated manner with data collected under rule G-36.

[3] Currently, the assessment under rule A-13 is $.03 per $1,000 par value for offerings containing securities two years or more in maturity. If the longest maturity in an offering is over nine months but less than two years, the assessment is $.01 per $1,000 par value of the issue. For purposes of calculating the assessment, a put option date is treated the same as a maturity date, *e.g.*, a primary offering of a security with a put option of one year would generate an assessment at the $.01 rate.

[4] These kinds of primary offerings are defined as those that are sold to no more than 35 persons each of whom the underwriter reasonably believes (i) has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment and (ii) is not purchasing for more than one account or with a view to distributing the securities.

However, after looking at alternative assessment mechanisms and methods of establishing accounts receivable available at that time, the Board concluded that a fee based on underwriting participation was the best available means to create verifiable assessments generally reflecting a dealer's involvement in the market.

The Amendment

The Board is aware that, in negotiated underwritings, the subject of rule A-13 fees sometimes is raised in the context of discussions of expenses to be paid by the issuer of the securities. The Board believes that it is misleading for underwriters to characterize rule A-13 fees in this fashion. Since rule A-13 fees are assessments on dealers for the operation of the Board, the Board believes that a dealer's obligation under rule A-13 should not be charged or otherwise passed through to an issuer as an expense to the issuer of bringing a new issue to market. In this respect, the fees paid to the Board by dealers under rule A-13 should be characterized by dealers to issuers no differently than the annual fees paid to the Board under rule A-14 and any other "overhead" expenses that are incurred by virtue of the dealer engaging in municipal securities business. The amendment filed with the Commission accordingly states that dealers may not charge or otherwise pass through rule A-13 fees to issuers.

As noted above, the Board is aware that a dealer's level of participation in primary offerings is not a perfect mechanism to measure the dealer's involvement in the municipal securities market. A potential byproduct of the Board's proposed transaction reporting program[6] is that it may provide an additional base of information upon which a dealer's involvement in the municipal securities market can be measured. The Board plans in the future to consider whether transaction information from the proposed program could be used to more accurately assess dealers for the costs of Board operations, based upon each dealer's participation in the market.

August 15, 1994

Text of Proposed Amendment*

Rule A-13. Underwriting Assessment for Brokers, Dealers and Municipal Securities Dealers

(a) - (d) No change.

(e) *Prohibition on Charging Fees Required Under this Rule To Issuers.* No broker, dealer or municipal securities dealer shall charge or otherwise pass through the fee required under this rule to an issuer of municipal securities.

[5] This point was discussed in the Board's December 12, 1975, exposure draft of rule A-13.

[6] *See* "Reporting Inter-Dealer Transactions to the Board: Rule G-14," *MSRB Reports* Vol. 14, No. 4 (August 1994) at 7 - 9.

* Underlining indicates new language.

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Recordkeeping and Record Retention Requirements Relating to Gifts and Gratuities: Rules G-20, G-8 and G-9

Amendments Approved

The amendments require dealers to keep and retain specific records on gifts and gratuities to others in relation to municipal securities activities.

On July 13, 1994, the Securities and Exchange Commission (SEC) approved amendments to rules G-8 and G-9, on recordkeeping and record retention, that relate to rule G-20, on gifts and gratuities.[1] The amendments require dealers to keep and retain specific records on gifts and gratuities given to others in relation to municipal securities activities. The amendments will become effective on August 19, 1994.

Background and Summary of Amendments

In general, rule G-20, on gifts and gratuities, was intended to prevent commercial bribery. The rule has three basic parts. First, rule G-20(a) prohibits dealers from, directly or indirectly, giving or permitting to be given any thing or service of value in excess of $100 per year to any person, other than to an employee or partner of the dealer, in relation to municipal securities activities of the person's employer.[2] All gifts given by a dealer and its associated persons are used to compute the $100 limitation. The $100 limitation applies to gifts and gratuities to customers, individuals associated with issuers, and employees of other dealers. In addition, based on the rule's "directly or indirectly" language, if a third party (*e.g.*, a consultant hired by a dealer) gives a gift to any such person at the request of the dealer, the value of the gift would be included in the $100 limitation.

Second, rule G-20(b) exempts certain payments from the $100 annual limit set forth in paragraph (a). These payments are termed "normal business dealings" and are defined as occasional gifts of meals or tickets to theatrical, sporting, and other entertainments, as well as the sponsoring of legitimate business functions that are recognized by the IRS as deductible business expenses, and gifts of reminder advertising. However, the rule also provides that such gifts can not be so frequent or so expensive as to raise a suggestion of unethical conduct.

Finally, rule G-20(c) provides that contracts of employment with or compensation for services rendered are not considered gifts or gratuities subject to the $100 limitation. Such arrangements, however, must be in writing and must include the nature of the proposed services, the amount of the proposed compensation, and the written consent of such person's employer.

The amendments require dealers to keep and retain specific records of all gifts and gratuities subject to paragraph (a) of the rule.[3] The amendments also require dealers to keep and retain records of all contracts of employment or agreements for compensation for services and all compensation paid as a result of those agreements.[4] These amendments are consistent with the rules of other self-regulatory organizations (SROs).

July 13, 1994

Text of Amendments*

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

(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

Questions about the amendments may be directed to Mark McNair, Assistant General Counsel.

[1] SEC Release No. 34-34372.

[2] "Person" has been interpreted by the Board in the context of rule G-20 to apply only to natural persons because the intent of the rule is to discourage dealers from inducing individual employees to act in a manner inconsistent with their obligations to, or contrary to the interests of, their employers. MSRB Interpretation of March 19, 1980. *MSRB Manual* (CCH) para. 3571.24.

[3] Dealers, however, would not be required to keep and retain specific records of "normal business dealings" covered by paragraph (b) of the rule.

[4] The proposed rule change also clarifies that dealers complying with SEC Rule 17a-3 are required to maintain this information.

* Underlining indicates new language; strikethrough denotes deletions.

keep current the following books and records, to the extent applicable to the business of such broker, dealer, or municipal securities dealer.

(i) through (xvi) No change.

(xvii) Records Concerning Compliance with Rule G-20. Each broker, dealer, and municipal securities dealer shall maintain: (i) a separate record of any gift or gratuity referred to in rule G-20(a); and (ii) all agreements referred to in rule G-20(c) and all compensation paid as a result of those agreements.

(b) through (e) No change.

(f) Compliance with Rule 17a-3. ~~Municipal securities~~ Brokers, dealers and municipal securities dealers other than bank dealers which are in compliance with rule 17a-3 of the Commission will be deemed to be in compliance with the requirements of this rule, provided that the information required by subparagraph (a)(iv)(D) of this rule as it relates to uncompleted transactions involving customers; paragraph (a)(viii); paragraph (a)(xi); paragraph (a)(xii); [and] paragraph (a)(xiii), and paragraph (a)(xvii) shall in any event be maintained.

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) through (viii) No change.

(ix) the records regarding information on gifts and gratuities and employment agreements required to be maintained pursuant to rule G-8(a)(xvii).

(b) through (g) No change.

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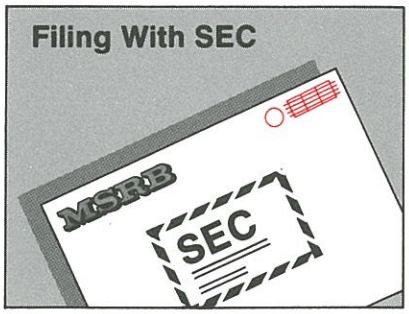

Route to:

- ☒ Manager, Muni Dept.
- ☒ Underwriting
- ☒ Trading
- ☐ Sales
- ☐ Operations
- ☒ Public Finance
- ☐ Compliance
- ☐ Training
- ☐ Other

MSIL System Change

Amendment to Facility Filed

The Board has filed a MSIL system change to make the 1991 and 1993 collections of imaged official statements and advance refunding documents available from the OS/ARD subsystem. The collections are available as of August 9, 1994. Digital audio tapes (DATs) containing the images of the 1991 collection may be purchased for $8,000 plus shipping costs, and DATs of the 1993 collection may be purchased for $9,000 plus shipping costs.

On August 9, 1994, digital audio tapes (DATs) containing the 1991 and 1993 collections of imaged official statements and advance refunding documents became available from the Official Statement/Advance Refunding Document (OS/ARD) subsystem of the Municipal Securities Information Library™ (MSIL™) system.[1] The 1991 collection may be purchased for $8,000 plus shipping costs, and the 1993 collection may be purchased for $9,000 plus shipping costs.[2] The $12,000 subscription fee for the daily DAT service for the current year remains unchanged. In addition, individual paper copies of official statements and advance refunding documents are available at $15 each plus shipping costs.

August 9, 1994

Questions about this notice may be directed to Thomas A. Hutton, Director of MSIL.

[1] MUNICIPAL SECURITIES INFORMATION LIBRARY and MSIL are trademarks of the Board. For a more complete description of the OS/ARD subsystem, see *MSRB Reports* vol. 12, No. 2 (July 1992) at 3.
[2] SEC File No. SR-MSRB-94-11.

Publications List

Manuals and Rule Texts

MSRB Manual
Soft-cover edition containing the text of MSRB rules, interpretive notices and letters, samples of forms, texts of the Securities Exchange Act of 1934 and of the Securities Investor Protection Act of 1970, as amended, and other applicable rules and regulations affecting the industry. Reprinted semi-annually.
April 1, 1994 ..... $5.00

Glossary of Municipal Securities Terms
Glossary of terms (adapted from the State of Florida's *Glossary of Municipal Bond Terms*) defined according to use in the municipal securities industry.
1985 ..... $1.50

Instructions for Filing Forms G-36
This publication is available to assist underwriters in submitting official statements, advance refunding documents and complete and correct Forms G-36.
1994 ..... no charge

Professional Qualification Handbook
A guide to the requirements for qualification as a municipal securities representative, principal, sales principal and financial and operations principal, with questions and answers on each category. Includes sections on examination procedures, waivers, disqualification and lapse of qualification, the text of MSRB qualification rules and a glossary of terms.
1990 ..... 5 copies per order ..... no charge
Each additional copy $1.50

Manual on Close-Out Procedures
A discussion of the close-out procedures of rule G-12(h)(i) in a question and answer format. Includes the text of rule G-12(h)(i) with each sentence indexed to particular questions, and a glossary of terms.
January 1, 1985 ..... $3.00

Arbitration Information and Rules
Based on SICA's *Arbitration Procedures* and edited to conform to the Board's arbitration rules, this pamphlet includes the text of rules G-35 and A-16, a glossary of terms and list of other sponsoring organizations.
1991 ..... no charge

Instructions for Beginning an Arbitration
Step-by-step instructions and forms necessary for filing an arbitration claim.
1991 ..... no charge

The MSRB Arbitrator's Manual
The Board's guide for arbitrators. Based on SICA's *The Arbitrator's Manual*, it has been edited to conform to the Board's arbitration rules. It also contains relevant portions of the *Code of Ethics for Arbitrators in Commercial Disputes*.
1991 ..... $1.00

Reporter and Newsletter

MSRB Reports
The MSRB's reporter and newsletter to the municipal securities industry. Includes notices of rule amendments filed with and/or approved by the SEC, notices of interpretations of MSRB rules, requests for comments from the industry and the public and news items.
Quarterly ..... no charge

Examination Study Outlines

A series of guides outlining subject matter areas a candidate seeking professional qualification is expected to know. Each outline includes a list of reference materials and sample questions.

Study Outline: Municipal Securities Representative Qualification Examination
Outline for Test Series 52
July 1992 ..... no charge

Study Outline: Municipal Securities Principal Qualification Examination
Outline for Test Series 53
January 1993 ..... no charge

Brochure

MSRB Information for Municipal Securities Investors
Investor brochure describing Board rulemaking authority, the rules protecting the investor, arbitration and communication with the industry and investors. Use of this brochure satisfies the requirements of rule G-10.
1 to 500 copies ..... no charge
Over 500 copies ..... $.01 per copy

Publications Order Form

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MSRB Manual (soft-cover edition)	$5.00		
Glossary of Municipal Securities Terms	$1.50		
Professional Qualification Handbook	5 copies per order no charge Each additional copy $1.50		
Manual on Close-Out Procedures	$3.00		
Instructions for Filing Forms G-36	no charge		
Arbitration Information and Rules	no charge		
Instructions for Beginning an Arbitration	no charge		
The MSRB Arbitrator's Manual	$1.00		
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Study Outline: Municipal Securities Principal Qualification Examination	no charge		
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