MSRB REPORTS

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From Chairman David C. Clapp

1994 and Beyond: Important Changes for Our Industry

It has been the custom that this letter from the Chairman appears in *MSRB Reports* in the autumn, which coincides with the Board's first meeting with its new officers and members. This year it seemed more appropriate to wait until after some of the very important developments underway had begun to take final form. This brings us to January, 1994, the first month in a year that could well see the greatest changes in the industry since the creation of the MSRB in 1975; and the issues the Board will address in 1994 will continue to be worked on well beyond this year and change the nature of the municipal business as it moves into the 21st century.

I am sure that most of you know of the Board's efforts to remove any real or perceived connection between political contributions and the awarding of municipal securities business. In this issue of *MSRB Reports* you will find the proposed rule we have filed with the SEC for approval. In my judgment, the swift resolution of this issue is imperative; all our efforts in other areas will suffer greatly if the integrity of our industry is open to repeated questions. You will have an opportunity to comment to the SEC when the draft rule is published shortly in the *Federal Register* and I urge you to support the Board's

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From Chairman David C. Clapp

(continued from front page)

proposal, but I also urge you to comment as you believe appropriate.

While much of the media attention has focused on the role of political contributions, everyone in the industry should understand that the Board is committed to addressing other issues where a potential conflict of interest is involved. Specifically, issues involving financial advisors, lawyers and others serving as lobbyists and the role of so-called finders may not seem fully resolved, but they are not forgotten. Relatedly, the Board will continue to be attentive to attempts to circumvent either the words or the spirit of any MSRB rules.

Everyone should be aware that there are three other issues of equal importance which, in some ways, will have a more lasting impact on the way municipal business is conducted. First, we expect to continue to provide participation and cooperation working with industry groups and the SEC to take actions that result in an improved and timely flow of continuing disclosure information to investors and other concerned market participants. We have indicated to all parties our willingness to have the MSIL system used for this purpose. Certainty regarding what and when information will be available to market participants is critical to efficient pricing and to proper suitability determinations.

Second, the Board is announcing in this issue of *MSRB Reports* that it intends to proceed rapidly on providing market participants and regulators with more transaction and pricing information, *i.e.*, increasing price transparency. The proposal outlined is but the *first step* to achieving a level of transparency that meets the expectations of investors and regulators charged with surveillance in this market.

Third, much work will need to be done in the next 18 months if this industry is to move in step with the other segments of the securities industry to a three-day clearance and settlement cycle. The Board is aware that there is a lengthy history concerning settlement cycles and that it is a complicated subject for the municipal industry. Efforts to move to the shorter cycle will involve significant time and costs. But there is a consensus among regulators that settlement cycles must be shortened for a number of reasons.

When all of these matters are completed, which might well take two to three years, the face of the municipal securities market will be vastly different. Some of the changes will be a bit painful. In regard to the rule at hand, please read *all* of the material related to rule G-37. It is somewhat extensive but it provides very valuable information which will enable industry participants to fully understand what the Board proposes to accomplish.

Finally, I would like to say again what so many of you have said: our business is a marvelous, unique business, a true wonder to the rest of the world. And it is an honest business. MSRB rules, far from contradicting any of this, are designed to help keep things that way.

Sincerely,

David C. Clapp
Chairman 1993-1994

The Board's Municipal Securities Information Library™ system is now at the following address:

MSRB
MSIL System
1640 King Street, Suite 300
Alexandria, VA 22314-2719

Dealers that submit official statements and advance refunding documents to the Board pursuant to Board rule G-36, and issuers and trustees that voluntarily send paper copies of continuing disclosure information to the CDI Pilot, should address their submissions to the above address as of January 1, 1994.

Staff Appointment

Larry M. Lawrence has been appointed Policy and Technology Advisor in the Rulemaking/Policy group. For the past 11 years, he worked with The MITRE Corporation in McLean, Virginia. He previously worked with Arthur Young & Company and Indiana University. Mr. Lawrence received his B.A. degree from Harvard College, and his M.A., Biology, and M.B.A., Management Information Systems, from Indiana University.

Calendar

Aug. 20, 1993 — Effective date for amendments to rule G-35, on arbitration

Feb. 1, 1994 — Effective date for amendment to rule G-12(f)(i) requiring essentially all inter-dealer transactions in securities with CUSIP numbers to be compared in an automated comparison system

March 15 — Comments due on draft amendments to rules G-8 and G-9 that relate to rule G-20, on gifts and gratuities

March 18 — Due date for recommendations for Board nominations

Pending
- Proposed rule G-37, on political contributions and prohibitions on municipal securities business
- Amendments to rule G-15(d)(ii) which will eliminate exemptions in the rule that currently allow dealers to avoid use of automated confirmation/acknowledgment systems for certain institutional customer transactions
- Amendments to rules G-19 and G-8 relating to suitability of recommendations and related recordkeeping requirements

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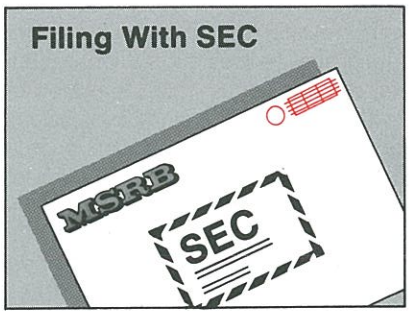

Route to:

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

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

Proposed Rule Filed

Proposed rule G-37 prohibits dealers from engaging in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: (i) the dealer; (ii) any municipal finance professional associated with such dealer; or (iii) any political action committee controlled by the dealer or any municipal finance professional. The proposed rule also includes a requirement for quarterly reporting by dealers of certain information regarding political contributions made and municipal securities business engaged in to the Board, which will make such information publicly available. In addition, amendments to rules G-8 and G-9, on recordkeeping and record retention, respectively, also have been filed.

On January 12, 1994, the Board filed with the Securities and Exchange Commission (Commission) proposed rule G-37 on political contributions and prohibitions on municipal securities business. The proposed rule prohibits brokers, dealers and municipal securities dealers (dealers) from engaging in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: (i) the dealer; (ii) any municipal finance professional associated with such dealer; or (iii) any political action committee controlled by the dealer or any municipal finance professional. One exception to this prohibition is discussed below. Proposed rule G-37 also includes a requirement for quarterly reporting by dealers of certain information regarding political contributions made and municipal securities business engaged in to the Board, which will make such information publicly available. In addition, amendments to rules G-8 and G-9, on recordkeeping and record retention, respectively, also have been filed. The prohibition on engaging in municipal securities business will arise from contributions made on or after April 1, 1994. In addition, the recordkeeping and disclosure requirements apply only to contributions made or municipal securities business engaged in on or after April 1, 1994. The proposed rule and the amendments will become effective upon approval by the Commission. Persons wishing to comment on the proposed rule and the amendments should comment directly to the Commission.[1]

Introduction

Over the last few years, the Board has become increasingly concerned about the opportunity for abuses and the problems associated with political contributions in connection with the awarding of municipal securities business. The Board believes, based on comment letters and other information, that there have been numerous instances in which dealers have been awarded municipal securities business based on their political contributions. Even where such improprieties have not transpired, political contributions create a potential conflict of interest for issuers, or at the very least the appearance of a conflict, when dealers make contributions to officials responsible for, or capable of influencing the outcome of, the awarding of municipal securities business and then are awarded business by issuers associated with these officials. The problems associated with political contributions undermine investor confidence in the municipal securities market, which is crucial to the long-term health of the market, both in terms of liquidity and capital-raising ability. In addition, in order to promote just and equitable principles of trade, the awarding of business should be based on merit, and not on political contributions. The payment of such contributions to obtain business creates artificial barriers to those dealers not willing or able to make such payments, thereby harming investors and the public interest by stifling competition and increasing market costs associated with doing municipal securities business. Accordingly, the Board has determined that regulatory action is necessary to protect investors and maintain the integrity of the market.

Background

The Board has monitored and discussed the issues surrounding political contributions since its November 1990 meeting. In August 1991, the Board published a notice expressing

Questions about the proposed rule or amendments may be directed to Diane G. Klinke, General Counsel, or Jill C. Finder, Assistant General Counsel. A summary and discussion of the comments received on the Board's August 1993 draft rule G-37 is included in the Board's filing with the Commission. Persons seeking a copy of the filing should contact the Board's offices.

[1] Comments sent to the Commission should refer to SEC File No. SR-MSRB-94-2.

its concern that the process of selecting an underwriting team not be influenced by political contributions. The Board stated that it is critical that the market engender the highest degree of public confidence so that investors will provide much needed capital to state and local governments. Toward this end, the Board encouraged underwriters and state and local governments to maintain the integrity of the underwriter selection process. In May 1993, the Board published a press release noting continuing concern by the Board, industry members and others regarding political contributions. The Board indicated that it planned to review its authority and options for rulemaking in this area.

In August 1993, the Board published for comment draft rule G-37 (August 1993 draft rule), which would have (1) prohibited dealers and their associated persons from making political contributions, directly or indirectly, to officials of issuers for the purpose of obtaining or retaining municipal securities business, and (2) required dealers and their associated persons to disclose, for a four-year period, all political contributions to officials of such issuers with whom they have done business. The Board also requested comments on draft amendments to rules G-8 and G-9, on recordkeeping and record retention, respectively, requiring the recording of information regarding certain political contributions. The vast majority of commentators supported the Board's efforts to alleviate the problems, both actual and potential, associated with political contributions, and thereby maintain the integrity of the market and protect investors and the public interest. However, none gave unqualified support for the August 1993 draft rule; every commentator suggested modifications. At its November and December 1993 meetings, the Board carefully considered the commentators' concerns and suggestions, and adopted the proposed rule change. The Board believes that the proposed rule change effectively addresses the problems of political contributions and the awarding of municipal securities business.

General Prohibition on Engaging in Municipal Securities Business

Proposed rule G-37 would prohibit any dealer from engaging in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: (i) the dealer; (ii) any municipal finance professional associated with such dealer; or (iii) any political action committee (PAC) controlled by the dealer or any municipal finance professional. One exception to this prohibition is discussed below.

The proposed rule change is not a ban on political contributions—it is a ban on engaging in municipal securities business with an issuer after certain contributions are made to officials of such issuer. The term "municipal securities business" is defined in the proposed rule to encompass certain activities of dealers, such as acting as negotiated underwriters (as managing underwriter or as syndicate member), financial advisors and consultants, placement agents, and negotiated remarketing agents.[2] Thus, a dealer could not provide any of these services to an issuer within two years after the dealer, any dealer-controlled PAC or any municipal finance professional made contributions to an official of such issuer. This prohibition on business also would result if a municipal finance professional associated with a dealer made such a contribution prior to becoming associated with the dealer (*i.e.*, the two-year ban on business applies to both the current and prior employer of the municipal finance professional). This is intended to prohibit the new employer from obtaining municipal securities business based on prior contributions by its municipal finance professionals.

The prohibitions on business under the rule arise from contributions made on or after April 1, 1994. This date was set so that dealers could begin to monitor those political contributions that may subject them to restrictions on engaging in municipal securities business.

An "official of an issuer" is defined 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 includes any issuer official or candidate (or successful candidate) who has influence over the awarding of municipal securities business so that contributions to certain state-wide executive or legislative officials (*e.g.*, governors) would be included within the proposed rule change's prohibition on engaging in municipal securities business.

"Contributions" which invoke application of the prohibition include any gift, subscription, loan, advance, or deposit of money or anything of value made: (i) for the purpose of influencing any election for federal, state[3] or local office; (ii) for payment or reduction of debt incurred in connection with any such election; or (iii) for transition or inaugural expenses incurred by the successful candidate for state or local office. The Board has decided to include all such payments within the parameters of proposed rule G-37 because of concern that such types of payments, in the past, have or may have been connected to the awarding of municipal securities business. The Board believes that the proposed rule's definition of contribution will cover all circumstances in which political contributions are made to state and local issuer officials and candidates who can influence the awarding of municipal securities business, both before and after election to state and local office. The Board wishes to sever any connection between contributions and municipal securities business. Any other payments to issuer officials are addressed in other Board rules, such as rule G-20 on gifts and gratuities.

Finally, the Board does not seek, through its definition of contribution, to restrict the personal volunteer work of municipal finance professionals in political campaigns other than soliciting or coordinating contributions.[4] However, if resources of the dealer are used (*e.g.*, a political position paper is prepared by dealer personnel) or expenses are incurred by the municipal finance professional in such personal volunteer work, the value of such resources or expenses would be included within the definition of contribution.

[2] The proposed rule would not prohibit dealers from acting as competitive underwriters or competitive remarketing agents.

[3] The term "state" is defined in Section 3(a)(16) of the Securities Exchange Act (Act) to mean any state of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. Rule D-1 provides that, unless the context otherwise requires, the terms used in the Board's rules shall have the same meanings set forth in the Act.

[4] Restrictions on soliciting or coordinating contributions are described below.

Exception for Certain Contributions

The only exception to the proposed rule change's absolute prohibition on business is for certain contributions made to issuer officials by municipal finance professionals. Contributions by such persons to officials of issuers would not invoke application of the prohibition on business, but only if the municipal finance professional is entitled to vote for such official and provided any contributions by such municipal finance professional do not exceed, in total, $250 to each official, per election.[5] The Board believes that this exception is appropriate because contributions of this nature present less opportunity for a conflict of interest or the appearance of a conflict of interest on the part of an issuer official in the awarding of municipal securities business.

The term "municipal finance professional" means: (i) any associated person primarily engaged in municipal securities representative activities, as defined in rule G-3(a)(i);[6] (ii) any associated person who solicits municipal securities business; (iii) any direct supervisor of such persons up through and including, in the case of a 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 (iv) any member of the dealer executive or management committee or similarly situated officials, if any (or, in the case of a bank dealer, similarly situated officials in the separately identifiable department or division of the bank, as defined in rule G-1).

Included within the definition of municipal finance professional is any associated person of the dealer involved in the solicitation of municipal securities business or bringing to market new issue municipal securities. The definition also includes those individuals who have an economic interest in seeing that the dealer is awarded municipal securities business and who 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 activities. The Board does not intend to include within the definition of municipal finance professional retail sales persons who primarily sell other products or associated persons employed in departments other than the municipal securities department.

Direct and Indirect Contributions

In addition to the prohibition on business described above, the proposed rule also would prohibit a dealer and any municipal finance professional from doing any act indirectly which would result in a violation of the proposed rule if done directly by the dealer or municipal finance professional. This proscription was modeled after Section 20(b) of the Securities Exchange Act[7] and is intended to prohibit those parties subject to the proposed rule from using other persons or entities as conduits in order to circumvent the proposed rule. A dealer would violate the proposed rule by engaging in municipal securities business with an issuer after directing a person to make a contribution to an official of such issuer. For example, a violation would result if a dealer does business with an issuer after directing contributions by associated persons, family members of associated persons, consultants, lobbyists, attorneys, other dealer affiliates, their employees or PACs, or other persons or entities as a means to circumvent the rule. Finally, the dealer would violate the rule by doing business with an issuer after providing money to any person or entity when the dealer knows that such money will be given to an official of an issuer who could not receive such a contribution directly from the dealer without triggering the rule's prohibition on business. For example, in certain instances, a local political party may be soliciting contributions for the purpose of supporting one issuer official. If this is the case, contributions made to the political party would result in the same prohibition on municipal securities business as would a contribution made directly to the issuer official.

Solicitation and Bundling Prohibition

The proposed rule also would prohibit a dealer and any municipal finance professional from soliciting the parties described above, as well as any other person or entity, to make contributions to an official of an issuer with which the dealer engages or is seeking to engage in municipal securities business or to coordinate (*i.e.*, bundle) contributions.[8] Dealers may not engage in municipal securities business with issuers if they or their municipal finance professionals engage in any kind of fund-raising activities for officials of such issuers. As noted previously, municipal finance professionals may volunteer their personal services in other ways to political campaigns.

Recordkeeping Requirements

To facilitate compliance with, and enforcement of, proposed rule G-37, the Board also proposes to amend existing rules G-8 and G-9, concerning recordkeeping and record retention, respectively. The amendment to rule G-8 is designed to assist dealers in determining whether or not they may engage in

[5] Thus, if an issuer official (*i.e.*, incumbents and/or candidates) for whom the municipal finance professional is entitled to vote is involved in a primary prior to the general election, the municipal finance professional could contribute up to $500 for each such official (*i.e.*, $250 per election).

[6] Rule G-3(a)(i) defines the term "municipal securities representative" as a person associated with a dealer, other than a person whose functions are solely clerical or ministerial, whose activities include one or more of the following: (A) underwriting, trading or sales of municipal securities; (B) financial advisory or consultant services for issuers in connection with the issuance of municipal securities; (C) research or investment advice with respect to municipal securities; or (D) any other activities which involve communication, directly or indirectly, with public investors in municipal securities; provided, however, that the activities enumerated in subparagraphs (C) and (D) are limited to such activities as they relate to the activities enumerated in subparagraphs (A) and (B).

[7] Section 20(b) provides that:

> It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this title or any rule or regulation thereunder through or by means of any other person.

[8] By the term "seeking to engage in municipal securities business" the Board means dealer activities including responding to Requests for Proposals, making presentations of public finance capabilities, and other soliciting of business with issuer officials.

business with a particular issuer. These amendments would require a dealer to maintain a list of: (i) names, titles, city/county and state of residence of every municipal finance professional; (ii) names, titles, city/county and state of residence of all executive officers;[9] (iii) the states in which the dealer is engaging or is seeking to engage in municipal securities business; (iv) every issuer with which municipal securities business has been conducted during the current year, as well as the previous two years and, where applicable, the name, company, role and compensation arrangement of any person employed by the dealer to obtain or retain municipal securities business with such issuer; and (v) all contributions, direct or indirect, to officials of issuers and to political parties of states and political subdivisions made by the dealer, any dealer-controlled PAC, any municipal finance professional or executive officer. The dealer would not, however, be required to maintain a list of contributions by its municipal finance professionals or executive officers that are made: (i) to officials for whom the person is entitled to vote, provided such contributions do not exceed $250 to each issuer official, per election; and (ii) to political parties for the state and political subdivision in which the person is entitled to vote, provided such contributions do not exceed $250 per party, per year. In addition, dealers would not be required to maintain a list of contributions by any other employees, affiliate companies and their employees, spouses of covered employees, or any other person or entity unless the contributions were directed by persons or entities subject to the proposed rule.

The Board determined to add a recordkeeping requirement for contributions made by executive officers and contributions made to political parties to help ensure that dealers, dealer-controlled PACs and municipal finance professionals do not circumvent the prohibition on business in the proposed rule by indirect contributions to issuer officials through executive officers or to state or local political parties. Upon review by the enforcement agencies of such information, the Board may determine that further revisions to the proposed rule change in this area would be appropriate.

In addition, a number of commentators expressed concern about the use of consultants by dealers to obtain or retain municipal securities business. Again, once the prohibition on business in the proposed rule change is put into effect, the Board is concerned that use of consultants who make contributions to issuer officials may increase. Thus, the proposed rule change also would require dealers to record every issuer with which municipal securities business has been conducted, the type of business, and, where applicable, the name, company, role and compensation arrangement of any person employed by the dealer to obtain or retain municipal securities business with the issuers listed.

The records would not have to be maintained for contributions made or business engaged in prior to April 1, 1994. The amendment to rule G-9 would require dealers to maintain these records, required pursuant to the proposed amendments to rule G-8, for a six-year period.

Disclosure Requirements

Proposed rule G-37 would require dealers to report to the Board certain summary information concerning contributions in order to allow for public access to such information. Contributions to be reported include those to officials of issuers and political parties of states and political subdivisions made by: (i) the dealer; (ii) any municipal finance professional; (iii) any executive officer; and (iv) any PAC controlled by the dealer or by any municipal finance professional. Only such contributions over a *de minimis* amount, *i.e.*, those required to be recorded under rule G-8, would be disclosed.

Reports, on Form G-37, would be submitted to the Board in accordance with Board rule G-37 filing procedures, quarterly, with due dates determined by the Board and would include, by state: (i) the name, title (including any city/county/state or other political subdivision) of each official of an issuer and political party receiving contributions; (ii) total number and dollar amount of contributions made by the persons and entities described above; and (iii) such other identifying information as required by Form G-37. The names of individual municipal finance professionals and executive officer contributors would not be disclosed. Such reports also would include a list of issuers with which the dealer has engaged in municipal securities business during the reporting period, 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 believes that it is important to provide certain summary information on contributions to the public to help assure investors in the municipal securities market that dealers are not engaging in municipal securities business with issuers to whom contributions have been made by the dealer, dealer-controlled PACs and municipal finance principals. In addition, the Board is concerned that, once the prohibition on business in the proposed rule change is put into effect, dealers may seek to continue making contributions to obtain business through contributions by executive officers or to political parties. Thus, the proposed rule change requires disclosure of such contributions. Finally, as noted above, to reduce the opportunity for dealers to circumvent the rule's requirements through the use of consultants and other persons, disclosure of the dealer's municipal securities business activities and information about persons hired to obtain or retain such business would be required.

The Board believes that public access to this information will help to assure investors in the municipal securities market that dealers are awarded business based on merit, not political contributions. Where this is not the case, the information provided should assist state and federal officials in detecting and correcting such situations.

In order to ensure equal public access to information provided on Form G-37, the Board will include this information in its Municipal Securities Information Library™ (MSIL™) system, the Board's electronic library. The Board is in the process of developing appropriate rule G-37 filing procedures to allow for public access to the information to be submitted on Form G-37, as well as indexing, record storage, etc. It will seek information from a wide variety of information submitters (*i.e.*, dealers) and potential information users (*i.e.*, information

[9] An executive officer is defined in the proposed rule as any associated person in charge of a principal business unit, division or function or any other person who performs similar policy making functions for the dealer, but does not include any municipal finance professional.

services, newspapers, etc.) The Board's initial filing procedures, of necessity, will be flexible and may allow for many means of information submission (*e.g.*, paper and electronic). Once the Board gains experience with such submissions, it will seek to modify its procedures to make searches easier and data collection and storage more cost-effective.

Finally, the Board understands that a number of dealers have offered voluntarily to submit additional information on contributions to a repository for public access and dissemination. So too, certain non-dealer municipal market participants also may wish voluntarily to provide a central repository with contribution information. The proposed rule notes that the Board will accept additional information related to contributions voluntarily submitted by dealers or others as long as such information is submitted in accordance with Board filing procedures. The Board is considering whether it may have to charge a filing fee to cover expenses associated with certain of this voluntarily submitted information. It is also reviewing what kinds of access fees to the forms filed, if any, would be appropriate.

Dealer Compliance Procedures

Pursuant to rule G-27, on supervision, each dealer must adopt, maintain and enforce written supervisory procedures reasonably designed to ensure compliance with Board rules. In regard to the proposed rule change, effective compliance procedures are essential because the proposed rule would require dealers to have information regarding each contribution made by the dealer, dealer-controlled PACs and municipal finance professionals so that it can determine where and with whom it may or may not engage in municipal securities business. In addition, it must have information on executive officer and political party contributions and consultant hiring practices for disclosure purposes. Moreover, because of the "directly and indirectly" provision in section (d) of the proposed rule change, as well as the no solicitation and no bundling provisions in section (c), dealers would have to take measures to ensure that those persons and entities subject to the proposed rule are not causing the dealer to be in violation. Furthermore, the dealer must ensure that other people and entities hired to assist in municipal securities activities (*e.g.*, consultants) are not being directed to make contributions that might result in a violation of the proposed rule change.

Because dealer compliance procedures for the proposed rule change, of necessity, will be quite extensive, dealers may wish to review the work of a number of dealers and organizations that are seeking to develop model compliance procedures in this area. While the Board cannot specifically approve any such procedures, it believes that dealers may benefit from these efforts.

In addition, the Board wishes to note that the proposed rule change sets forth a minimum standard of conduct for dealers involved in municipal securities business. The Board has sought to target the proposed rule's requirements to the areas of abuse to which it has been alerted, while reducing potentially burdensome requirements where appropriate. Dealers are urged, where possible, to do even more to sever any possible connection between political contributions and the awarding of municipal securities business.

* * * * *

The Board has adopted the proposed rule change 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 proposed rule to make its prohibitions applicable to a broader range of entities and individuals or to include other prohibitions or disclosure requirements. The Board urges the dealer community to put into place as soon as possible procedures designed to comply effectively with the proposed rule so that the industry can move past the allegations of impropriety and back to providing important financing services, thereby effectively meeting the needs of state and local governments.

January 12, 1994

Text of Proposed Rule, Amendments and Form G-37*

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

(a) *Purpose.* The purpose and intent of this rule are 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 by: (i) prohibiting brokers, dealers and municipal securities dealers from engaging in municipal securities business with issuers if certain political contributions have been made to officials of such issuers; and (ii) requiring brokers, dealers and municipal securities dealers to disclose certain political contributions, as well as other information, to allow public scrutiny of political contributions and the municipal securities business of a broker, dealer or municipal securities dealer.

(b) No broker, dealer or municipal securities dealer shall engage in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: (i) the broker, dealer or municipal securities dealer; (ii) any municipal finance professional associated with such broker, dealer or municipal securities dealer; or (iii) any political action committee controlled by the broker, dealer or municipal securities dealer or by any municipal finance professional; provided, however, that this section shall not prohibit the broker, dealer or municipal securities dealer from engaging in municipal securities business with an issuer if the only contributions made by the persons and entities noted above to officials of such issuer within the previous two years were made by municipal finance professionals to officials of such

* Underlining indicates new language; strikethrough denotes deletions.

issuer for whom the municipal finance professionals were entitled to vote and which contributions, in total, were not in excess of $250 by any municipal finance professional to each official of such issuer, per election.

(c) No broker, dealer or municipal securities dealer or any municipal finance professional of the broker, dealer or municipal securities dealer shall solicit any person or political action committee to make any contribution, or shall coordinate any contributions, to an official of an issuer with which the broker, dealer or municipal securities dealers is engaging or is seeking to engage in municipal securities business.

(d) No broker, dealer or municipal securities dealer or any municipal finance professional shall, directly or indirectly, through or by any other person or means, do any act which would result in a violation of sections (b) or (c) of this rule.

(e)(i) Each broker, dealer or municipal securities dealer shall submit to the Board, 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). 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 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 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) The term "contribution" means 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.

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

(iii) The term "broker, dealer or municipal securities dealer" used in this rule does not include its associated persons.

(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 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 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.

(v) The term "executive officer" means an associated person in charge of a principal business unit, division or function or any other person who performs similar policy making functions for 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), but does not include any municipal finance professional, as defined in paragraph (iv) of this section (g).

Each person listed by the broker, dealer or municipal securities dealer as an executive officer pursuant to rule G-8(a)(xvi) is deemed to be an executive officer.

(vi) The term "official of such issuer" or "official of an issuer" means any person who was, at the time of the contribution, an incumbent, candidate or successful candidate 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.

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

(A) the purchase of a primary offering (as defined in rule A-13(d)) of municipal securities from the issuer on other than a competitive bid basis (*i.e.*, negotiated underwriting); or

(B) the offer or sale of a primary offering of municipal

securities on behalf of any issuer (*i.e.*, private placement); or

(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; or

(D) the provision of remarketing agent services to or on behalf of an issuer with respect to a primary offering of municipal securities on other than a competitive bid basis.

(h) The prohibition on engaging in municipal securities business, as described in section (b) of this rule, arises only from contributions made on or after April 1, 1994.

Rule G-8. Books and Records to be Made by ~~Municipal Securities~~ 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 ~~municipal securities~~ broker, dealer and municipal securities dealer shall make and keep current the following books and records, to the extent applicable to the business of such ~~municipal securities~~ broker, dealer or municipal securities dealer:

(i) through (xv) No change.

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

(A) a listing of the names, titles, city/county and state of residence of all municipal finance professionals;

(B) a listing of the names, titles, city/county and state of residence of all executive officers;

(C) the states in which the broker, dealer or municipal securities dealer is engaging or is seeking to engage in municipal securities business;

(D) a listing 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 engaged in, during the current year and separate listings for each of the previous two calendar years. Where applicable, a listing of the name, company, role and compensation arrangement of any person employed by the broker, dealer or municipal securities dealer to obtain or retain municipal securities business with such issuers also shall be made;

(E) the contributions, direct or indirect, to officials of an issuer and 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, titles (including any city/county/state or other political subdivision) of the recipients of such contributions, and (iii) the amounts and dates of such contributions;

(F) the contributions, direct or indirect, to officials of an issuer made by each municipal finance professional and executive officer for the current and previous two calendar years, which records shall include: (i) the names, titles, city/county and state of residence of contributors, (ii) the names, titles (including any city/county/state or other political subdivision) of the recipients of such contributions, and (iii) the amounts and dates of such contributions; provided, however, that such records need not reflect any contribution made by a municipal finance professional or executive officer to officials of an issuer for whom such person is entitled to vote if the contributions by such person, in total, are not in excess of $250 to any official of an issuer, per election; and

(G) the contributions, 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, titles (including any city/county/state or other political subdivision) of the recipients of such contributions and (iii) the amounts and dates of such contributions; provided, however, that such records need not reflect those contributions 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 by such person, in total, are not in excess of $250 per political party, per year.

(H) Terms used in this paragraph (xvi) have the same meaning as in rule G-37.

(I) No record is required by this paragraph (a)(xvi) of any municipal securities business done or contribution made prior to April 1, 1994.

(b) through (f) No change.

Rule G-9. Preservation of Records

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

(i) through (vii) No change.

(viii) the records required to be maintained pursuant to rule G-8(a)(xvi).

(b) through (g) No change.

Proposed 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

Volume 14, Number 1

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Route to:

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

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

Comments Requested

The Board is requesting comment on draft amendments to rules G-8 and G-9, on recordkeeping and record retention, that relate to rule G-20, on gifts and gratuities. The draft amendments would require dealers to keep specific records on gifts and gratuities given to others in relation to municipal securities activities. Additionally, the Board is reviewing dealings between dealers and issuer officials and employees and requests information and comments in this area.

Recently, the municipal securities market has come under increased scrutiny because of concerns that municipal securities dealers are influencing municipal securities issuers to hire such dealers for municipal securities business through the payment of political contributions and other monies to persons with influence over the dealer selection process. While the issue of political contributions is being addressed through proposed rule G-37, the Board believes that amendments to rules G-8 and G-9, on recordkeeping and record retention, are necessary to require dealers to keep specific records of other gifts and gratuities given to issuer officials and employees in relation to municipal securities activities. The Board requests comment on these draft amendments.

Additionally, because commentators on proposed rule G-37, on political contributions, raised a number of issues concerning gifts and gratuities, the Board now is reviewing how such payments by dealers to issuer officials and employees may impact the awarding of municipal securities business. The Board requests information and comments in this area. The deadline for written comments is March 15, 1994.

Current Requirements of Rule G-20

In general, rule G-20, on gifts and gratuities, was intended to prevent commercial bribery. The rule 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.[1] 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.

Rule G-20(b) exempts certain payments from the $100 annual limit. 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.[2]

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.

Draft Amendments

When the Board adopted rule G-20, the Board decided not to incorporate a separate recordkeeping requirement because it felt that such a requirement would be "unduly burdensome." Given current concerns about the connection of gifts and gratuities to the awarding of municipal securities business, the

Comments on the draft amendments should be submitted no later than March 15, 1994, and may be directed to Mark McNair, Assistant General Counsel. Written comments will be available for public inspection after Board review.

[1] "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.

[2] When the Board filed rule G-20 with the SEC, it stated in the filing that the rule was not intended to "proscribe legitimate compensation for services rendered, or to restrict social relationships or legitimate business functions that do not suggest impropriety."

Board now believes that requiring dealers to keep specific records of any such payments provided to persons, if in connection with municipal securities activities, is necessary and will help to ensure appropriate standards are maintained in dealings with such persons. The Board also believes that specific recordkeeping requirements will facilitate dealer compliance with rule G-20, and assist enforcement agencies in monitoring compliance with the rule.[3] These draft amendments are consistent with the rules of other self-regulatory organizations (SROs).

Dealings with Issuer Officials and Employees

In response to a request for comment on proposed rule G-37, on political contributions, commentators raised a number of issues concerning dealings between dealers and issuer officials. The Board is considering whether it is necessary or appropriate to place additional requirements in rule G-20 designed to deal with situations in which there may be an appearance of dealers improperly influencing issuer officials, *i.e.*, when gifts or payments are made to or at the request of issuer officials. However, prior to acting in this area, the Board is requesting additional information and comments.

The Board recognizes that, unlike other SRO rules on gift and gratuities, rule G-20 must take into consideration that municipal securities dealers interact with public officials who occupy a special position of public trust. As previously noted, the "normal business dealing" provision in rule G-20(b) sets forth certain permissible gifts and entertainments and currently applies to all persons. The Board is considering whether it would be appropriate to establish a new definition of "normal business dealings" for issuer officials and employees to change or limit such permissible gifts.

In addition, the Board has received information that some issuer officials solicit charitable and other contributions from dealers. Some dealers believe that, at certain times, they must make such contributions to be considered for business by the issuer. Currently, rule G-20 would not cover such payments because the payments are not "in relation to the municipal securities activities of the employer of the recipient."

The Board recognizes that dealers and associated persons often are active corporate and individual citizens in a community and, as such, make charitable contributions. So too, issuer officials may solicit dealers to contribute to many worthy charitable causes, as well as other organizations for educational or other functions. As with political contributions, however, certain contributions made as a result of a solicitation by a public official may be viewed as influencing the selection of the dealer in connection with municipal securities business.

Request for Comments

The Board specifically requests comment on the following:

1. Are there any entertainment or gift-giving practices of dealers with respect to issuer officials and employees that create an appearance of inappropriate influence?

2. Should a more restrictive "normal business dealings" provision be applicable to issuer officials and employees compared to the standard that would be applicable to other persons? Are there any particular practices that should be specifically prohibited or restricted? Should public disclosure of certain specific activities be required?

3. Should a requirement be established that a person associated with the dealer act as host at an entertainment event with an issuer official in order for such event to come under the definition of "normal business dealing?"

4. In addition to dealings with issuer officials, are there any constraints on dealings that also should be applicable to other persons, such as customers and employees of other dealers?

5. Although instances of problems associated with solicitations for charitable contributions by issuer officials have been brought to the Board's attention, can dealers provide additional examples of problems with solicitations—either to charities or other organizations or individuals?

6. If solicitations of dealers by issuer officials sometimes affect the underwriter selection process, how could this be addressed by rule? For example, should solicitations for payments to third parties be included in the $100 annual limitation for issuer officials making such solicitations? Or, should solicited contributions be permitted, provided dealers publicly disclose that they received a solicitation from an issuer official?

January 12, 1994

Text of Draft Amendments*

Rule G-8. Books and Records to be Made by ~~Municipal Securities~~ 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 ~~municipal securities~~ broker, dealer and municipal securities dealer shall make and keep current the following books and records, to the extent applicable to the business of such municipal securities broker, dealer or municipal securities dealer.

(i) through (xvi) (proposed) 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 (f) No change.

Rule G-9. Preservation of Records

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

(i) through (viii) (proposed) 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.

[3] In addition, the draft amendments require dealers to maintain a record of any contract of employment or compensation for services referred to in rule G-20(c) and all compensation paid as a result of those agreements.

* Underlining indicates new language; strikethrough denotes deletions.

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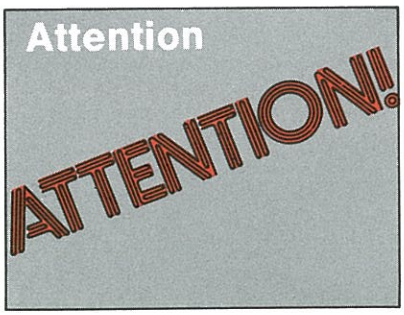

Route to:

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

Board to Proceed with Pilot Program to Disseminate Inter-Dealer Transaction Information

Pilot Program

The Board is going forward with its proposed pilot program for transaction reporting.

In May 1993, the Board proposed for comment a pilot program to collect inter-dealer transaction data and make certain market volume and pricing information public. In November 1993, the Board reviewed the comments received on the pilot program and decided to go forward with the program as proposed.

The pilot program is designed to achieve a certain degree of "transparency" with respect to transactions and price levels occurring in the municipal securities market. The Board believes that the pilot program, while limited in scope, nevertheless provides the appropriate starting point for introducing transparency to the municipal securities market. The pilot program is being designed so that the types of transaction data made public can be changed and expanded easily, based on comments from information users. It also is designed specifically to minimize the costs to dealers of reporting trades. As the industry and the Board obtain experience with transparency through the pilot program, the Board will seek cost-effective means to further increase transparency, with the ultimate goal being the dissemination of comprehensive, contemporaneous pricing data.

Description of the Pilot Program

The pilot program would use inter-dealer transaction data submitted for automated comparison to produce daily, public reports containing volume and pricing information. More detailed surveillance reports would be produced for enforcement agencies charged with enforcing Board rules.

Procedures for Submission of Transaction Data

In connection with the proposed pilot program, the Board plans to adopt a rule requiring dealers to report inter-dealer transactions to the Board for the purpose of providing public access to information on transaction volume and prices. Under the pilot program, the Board's agent for receiving transaction information from dealers would be National Securities Clearing Corporation (NSCC), a clearing corporation registered with the Securities and Exchange Commission under section 17A of the Securities Exchange Act.[1] Dealers would report transactions to NSCC simply by submitting the transactions for automated "comparison," a process that already is required under Board rule G-12(f)(i). 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.[2]

Daily Reports

NSCC currently completes processing of the initial comparison cycle for municipal securities on the night of trade date. The Board accordingly plans for the pilot program initially to release transaction data on the business day following trade date (T+1), as early in the day as possible.

The pilot program would release transaction data in a "daily report." The daily report would provide aggregate data about market volume on the previous business day and would provide specific price and volume data about those issues that were traded four or more times on that day. For each of these "frequently-traded 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. The average prices (but not the high and low prices) would be calculated based upon those trades in a "band" of $100,000 to $1 million par value.[3] The prices and par values of individual transactions would not be included in the daily

Questions about the pilot program may be directed to Harold L. Johnson, Deputy General Counsel.

[1] NSCC is the central processing facility for automated comparison of municipal securities transactions.

[2] Inter-dealer transactions that are not eligible for comparison are not subject to rule G-12(f)(i) and would not be subject to reporting under the pilot program. Ineligible transactions generally are limited to those in securities without CUSIP numbers. As of February 1,1994, all other inter-dealer transactions must be compared in the automated comparison system. *See MSRB Reports* Vol. 14, No. 1 (January 1994) at 17.

[3] This "average price" concept is intended to produce the average price of a "typical" inter-dealer transaction and is meant to exclude from the average price calculation factors that might affect "odd lot" transactions and large position movements.

report. A sample format for the daily report follows this notice.

The daily report would be made available to interested persons on equal terms. In particular, the Board would ensure that interested persons are provided access to the daily report on a non-discriminatory basis and in a manner that would not confer special or unfair economic benefit to any person. The Board also would encourage and facilitate the re-dissemination of the daily report by private information vendors so that the widest possible spectrum of market participants can be reached. The details of how the daily report will be made available have not yet been proposed, pending discussions with potential users.[4] The Board invites all persons interested in obtaining access to the daily report to provide their views at this time.

Surveillance Reports

Separate from the daily report—which will not identify dealer names—the Board will generate transaction data reports for those agencies responsible for enforcement of Board rules (surveillance reports). In its initial operations, the pilot program would generate surveillance reports containing the details of inter-dealer transactions, including the identity of dealers involved in the transactions and the prices of individual transactions. Surveillance reports would be used exclusively for market surveillance and enforcement purposes and would not be made public.[5]

Comments Received on Pilot Program

A notice describing the proposal to collect and publish inter-dealer transaction data was released for comment in May 1993.[6] The notice set forth the proposed method of collecting inter-dealer transaction data and the daily report, as described above. The notice asked for comment on the proposed program, including the types of data included in the daily report and the parameters under which data would be made public. Four comment letters were received in response to this notice. Two comments were from dealers, one was from NSCC and one was from a person interested in academic study of the data.

Format for Daily Report

One dealer commented that the reporting of transaction data by the Board should include a statement cautioning readers that prices are subject to change with market conditions and that prices for individual transactions may depend upon such factors as size of transaction, interest rate, maturity date, call features, sales charges, etc. NSCC suggested that the Board note that the daily report represents only those inter-dealer transactions that have been submitted for comparison.[7] The Board intends to include on or with the daily reports statements similar to those requested by the commentators. The Board believes that this will reduce the likelihood of confusion among persons reading the report who may not be familiar with the municipal securities market.

Average Price Calculation

One dealer expressed concern over the proposal to compute daily average prices based only upon those transactions falling within a specified band. The commentator noted that this would exclude some price information that otherwise might be available.[8] In contrast, however, another dealer suggested narrowing the band used for average price calculations by raising the $100,000 par value minimum. This commentator noted that, since NSCC compares zero-coupon bonds on the basis of maturity value, the average price calculation may include some trades that effectively are "odd lots."

The Board believes that, until the pilot program is actually operating and feedback is received from information users, it will be impossible to judge how well the "average price" concept actually works. The Board has decided to retain the concept at least for initial program operations. After some experience is gained, the Board will review how well the program is working and consider possible changes.

Compilations of Data

One commentator, a professor of Economics, urged the Board to provide compilations of transaction data (*e.g.*, a month of data on a computer disk) for academic study. The commentator acknowledged that subscribers to the daily report would also be able to offer data collections, but suggested that the Board would be in the best position to structure the types of compilations that would be most useful to market observers. The Board has decided to operate the pilot program for a period of time and to allow information vendors the opportunity to offer data compilations before deciding this issue.

Suggestions for Increased Information on Daily Reports

One dealer suggested that the Board publish individual transaction data (CUSIP number, securities description, par value, price) for each transaction, without regard to whether a security is being frequently traded on a specific day. This commentator believes that, by limiting the daily report to those individual maturities of an issue that are trading frequently, the pilot program would fail to report data that, in the aggregate, would be a reliable indicator of market prices. For example, the commentator believes that the general price levels for prerefunded securities could be extracted from aggregate transaction data on prerefunded securities, even if no one prerefunded security is trading frequently. In addition, the

[4] It is anticipated that a variety of organizations disseminating financial news would be interested in reprinting or otherwise disseminating all or part of the daily report. It is also anticipated that there would be demand for the daily report in electronic form from information vendors, bond funds, and other entities that price municipal issues each day.

[5] The Board has begun working with enforcement agencies to structure the format for the reports.

[6] *MSRB Reports* Vol. 13, No. 3 (June 1993) at 3-6.

[7] As noted above, the daily report would be generated from transactions that are "compared," on the night of trade date, in the automated comparison system. Transactions not eligible for automated comparison would not be subject to the trade reporting requirement.

[8] For example, if no transaction occurs within the $100,000 to $1 million "band," no average price would be reported. In this case, only the high and low prices, total number of trades, and par value traded would be reported.

proposed program treats each maturity of an issue separately for purposes of determining frequency of trading. The commentator believes that, when all maturities of an issue are considered together, there may be frequent trading in the issue as a whole (and, therefore, useful data) that the proposed program would not report.

In its pilot program proposal, the Board limited price reporting to "frequently traded" issues because of the concern that reporting an isolated transaction in an issue does not necessarily provide a reliable indicator of "market price" and might be misleading to someone not familiar with the market. If these concerns can be addressed, the Board believes that it would be desirable to enhance the pilot program along the lines suggested by the commentator.[9]

At this time, the Board plans to start the pilot program by reporting only on "frequently traded" issues as previously proposed, but to evaluate a possible expansion of the program after a year's experience is gained and comments on program operations are received from information users and the industry. During this evaluation, the Board's goal will be not only to expand the information contained in the daily report, but also to find cost-effective methods for providing even greater levels of transparency to the market, particularly with respect to customer transactions and the dissemination of transaction price information on a more contemporaneous basis. The Board also will be looking at how surveillance mechanisms can be improved by including customer transaction data in the surveillance reports provided to enforcement agencies.

* * *

Over the next few months, the Board will be working with NSCC to complete the planning for the pilot program. The Board also will be working with enforcement agencies on the development of surveillance reports. A rule filing with the SEC requiring transaction reporting to the Board is planned for later in 1994. The Board currently intends to begin pilot program operations in January 1995.

January 11, 1994

A sample of the price and volume report is contained on the following page.

[9] The pilot program is being designed to allow for easy expansion of the transaction data included on the daily report.

SAMPLE
Price and Volume Report
Inter-Dealer Municipal Securities Market

Trade Date:	08/05/91	Total Par Traded:	689,769,000
Total Number of Trades:	3,329	Total Number of Issues Traded:	1,938
Number of Issues Traded 4 or More Times:	90	Comparison Rate:	97%

CUSIP #	Security Description	Number of Trades	Volume Traded	High Price	Low Price	Avg. Price[1]	Trades Included in Avg Price
000000-AA-1	X Mun Util Dist Elec Rev Series Y 6.75% 09/01/2009	32	17,640,000	99.075	98.593	98.940	27
000001-BB-2	Y State Housing Agency Single Fam Mtg Sr-B-Rmkt 7.40% 07/01/2011	21	4,240,000	100.000	99.250	99.399	19
000002-CC-3	Z Commonwealth Electric Pwr Auth Pwr Rev 7% 07/01/2021 Ser. P	19	5,474,000	98.250	98.125	98.174	19
000003-DD-4	Y State Housing Agency Single Fam Mtg Sr-B-Rmkt 6.75% 07/01/2023	17	5,000,000	99.750	99.250	99.341	17
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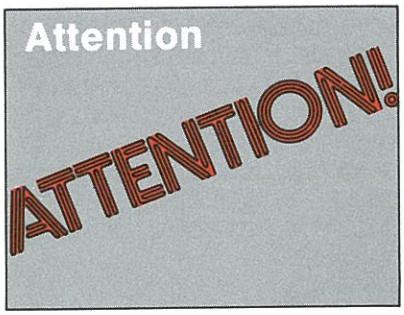
000099-ZZ-9	ZZ State MBIA Book Entry 6.90% 05/15/2003	4	600,000	102.036	101.961	101.999	4

[1] Average price includes only trades with par values between $100,000 and $1,000,000 inclusive.



Route to:

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

Developments Concerning T+3 Settlement and Automated Clearance and Settlement Rules: Rules G-12 and G-15

Amendment Approved and Amendment Filed

Recent initiatives affecting clearance and settlement of municipal securities include:

- **the SEC has requested that the Board develop a T+3 implementation plan for the municipal securities market;**
- **the SEC approved an amendment to rule G-12 on automated comparison effective February 1, 1994; and**
- **the Board filed an amendment to rule G-15, the final phase of its previously announced automated clearance initiative.**

In October 1993, the Securities and Exchange Commission approved SEC Rule 15c6-1, which will compress the current five-day settlement timeframe for regular-way transactions to three days (T+3 settlement).[1] The effective date of the rule has been set for June 1, 1995. Municipal securities were not included within the scope of Rule 15c6-1. The SEC, however, has asked the Board to develop a plan to achieve T+3 settlement for the municipal securities market and the Board currently is working on such a plan. This notice provides an update on the Board's T+3 settlement activities and describes related developments with respect to the Board's automated clearance and settlement rules.

T+3 Settlement

In February 1993, the SEC proposed and requested comment on Rule 15c6-1.[2] In its comment letter to the SEC, the Board noted that there were many unique features of the municipal securities market that affect clearance and settlement. For this reason, the Board urged that municipal securities not be included with other securities in the SEC rule.[3] The Board noted that it had made significant progress in improving clearance and settlement of municipal securities and was attempting to establish parity with the corporate securities market. The Board further noted that it was committed to improving municipal clearance and settlement consistent with national goals.[4] The Board asked that it be allowed to continue this process if the national goal of T+3 settlement was adopted. Based on the Board's letter, the SEC exempted municipal securities from the final version of Rule 15c6-1. At the same time, the SEC requested that the Board undertake the task of converting the municipal securities market to T+3 settlement.[5]

The Board currently is developing a T+3 settlement plan and expects to provide a final version to the SEC in March 1994. The plan will discuss actions that are necessary to ensure a successful conversion to T+3 settlement within the municipal securities market. These areas include automated comparison of inter-dealer transactions, automated confirmation/acknowledgment of institutional customer transactions, municipal issues that are not being made depository eligible, customer education programs and changes in various Board rules. The Board welcomes comment from industry members and other interested parties on the conversion to T+3 settlement, the actions that might be needed to ease the transition in the municipal securities industry, and a timeframe for taking such actions.

Amendments to Automated Clearance and Settlement Rules

Over the last 18 months the Board has amended rules G-12(f) and G-15(d) to remove exemptions in the rules that allowed certain inter-dealer and institutional customer transactions to be cleared and settled outside of automated clearance and settlement systems. These amendments are essential to the implementation of T+3 settlement, since the shorter

Questions about this notice may be directed to Harold L. Johnson, Deputy General Counsel, or Judith A. Somerville, Uniform Practice Specialist.

[1] SEC Release No. 34-33023 (October 6, 1993).
[2] SEC Release No. 34-31904 (February 23, 1993).
[3] See letter from Charles W. Fish, Chairman, Municipal Securities Rulemaking Board, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, *MSRB Reports*, Vol. 13, No. 3 (June 1993) at 11.
[4] In 1990, the Board adopted as one of its long-term goals the improvement of clearance and settlement systems for municipal securities consistent with national goals. See *MSRB Reports*, Vol. 10, No. 2 (May 1990) at 2.
[5] Letter from Arthur Levitt, Chairman, Securities and Exchange Commission, to David C. Clapp, Chairman, Municipal Securities Rulemaking Board (October 7, 1993).

settlement cycle will require increasing reliance on automated systems. The amendments also will improve the efficiency of municipal clearance and settlement and help to achieve uniformity with the automated clearance and settlement rules applicable to corporate securities transactions. The amendments have been described in previous editions of *MSRB Reports*.[6] Two recent developments are described below.

On December 2, 1993, the SEC approved an amendment to rule G-12(f)(i) on the use of automated comparison systems for inter-dealer transactions. The effective date of the amendment has been set for February 1, 1994. Once effective, the rule will require essentially all inter-dealer transactions in securities with CUSIP numbers to be compared in an automated comparison system.

On December 1, 1993, the final phase of the automated clearance amendments was filed with the SEC for approval. This rule filing—an amendment to rule G-15(d)(ii)—will eliminate exemptions in the rule that currently allow dealers to avoid use of automated confirmation/acknowledgment systems for certain institutional customer transactions. The Board has requested that the SEC set the effective date for the amendment to be July 1, 1994.

December 22, 1993

Text of Amendment*

G-12. Uniform Practice

(a) through (e) No changes.

(f) *Use of Automated Comparison, Clearance, and Settlement Systems.*

(i) Notwithstanding the provisions of sections (c) and (d) of this rule, ~~with respect to a transaction in municipal securities which are eligible for comparison through the facilities of a clearing agency registered with the Securities and Exchange Commission, if both parties to such transaction are members in one or more such clearing agencies (and such clearing agencies are interfaced or linked for comparison purposes), each party to the transaction shall submit to its clearing agency information concerning the transaction, as required by the clearing agency's rules, for purposes of automated trade comparison. In the event that a transaction submitted to a registered clearing agency for comparison in accordance with the requirements of this paragraph (i) shall fail to compare, the party submitting such transaction shall use the post-original-comparison procedures provided by the registered clearing agency in connection with such transaction until such time as the transaction is compared or final notification of a failure to compare the transaction is received from the contra-party.~~ a transaction eligible for automated trade comparison through the facilities of a clearing agency registered with the Securities and Exchange Commission (registered clearing agency) shall be compared through a registered clearing agency. Each party to such a transaction shall submit or cause to be submitted to a registered clearing agency all information and instructions required from the party by the registered clearing agency for automated comparison of the transaction to occur. In the event that a transaction submitted to a registered clearing agency for comparison in accordance with the requirements of this paragraph (i) shall fail to compare, the party submitting such transaction shall use the post-original-comparison procedures provided by the registered clearing agency in connection with such transaction until such time as the transaction is compared or final notification of a failure to compare the transaction is received from the contra-party.

(ii) through (iii) No changes.

(g) through (l) No changes.

Text of Proposed Amendment

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

(a) through (c) No changes.

(d) *Delivery/Receipt vs. Payment Transactions.*

(i) No change.

~~(ii) No broker, dealer or municipal securities dealer who is, or whose clearing agent with respect to such transaction is, a participant in a clearing agency registered with the Securities and Exchange Commission shall effect a transaction in any municipal security to which a CUSIP number has been assigned on a delivery vs. payment or receipt vs. payment basis for the account of a customer who is, or whose agent with respect to such transaction is, a participant in such clearing agency (or in a clearing agency interfaced or otherwise linked with such clearing agency) unless the facilities of such clearing agency (or the facilities of a clearing agency interfaced or otherwise linked with such clearing agency, as necessary) are used for the confirmation and acknowledgment of such transaction.~~

(ii) Except as provided in this paragraph, no broker, dealer or municipal securities dealer shall effect a customer transaction for settlement on a delivery vs. payment or receipt vs. payment (DVP/RVP) basis unless the facilities of a clearing agency registered with the Securities and Exchange Commission (registered clearing agency) are used for automated confirmation and acknowledgment of the transaction. Each broker, dealer and municipal securities dealer executing a customer transaction on a DVP/RVP basis shall: (A) ensure that the customer has the capability, either directly or through its clearing agent, to acknowledge transactions in an automated confirmation/acknowledgment system operated by a registered clearing agency; and (B) submit or cause to be submitted to a registered clearing agency all information and instructions required by the registered clearing agency for the production of a confirmation that can be acknowledged by the customer or the customer's clearing agent; provided that a transaction that is not eligible for automated confirmation and acknowledgment through the facilities of a registered clearing agency shall not be subject to this paragraph (ii).

(iii) No change.

(e) No change.

[6] See *e.g.*, *MSRB Reports*, Vol. 12, No. 1 (April 1992) at 31 and *MSRB Reports*, Vol. 12, No. 3 (September 1992) at 9.

* Underlining indicates additions; strikethrough indicates deletions.

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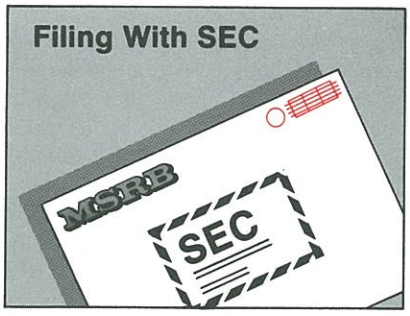
MSRB REPORTS

January 1994



Route to:

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

Suitability of Recommendations and Related Recordkeeping Requirements: Rules G-19 and G-8

Amendments Filed

The amendments: (1) clarify and strengthen the existing language of rule G-19 that requires suitability determinations to be made when recommending transactions to customers; (2) clarify the obligation of dealers to make reasonable efforts to obtain specific types of customer suitability information for all accounts that are not "institutional accounts" (*i.e.*, retail accounts); and (3) clarify the definition of "institutional account."

On January 6, 1994, the Board filed with the Securities and Exchange Commission proposed amendments to rules G-19 and G-8 relating to the suitability of recommendations to customers. The amendments: (1) clarify and strengthen the existing language of rule G-19 that requires suitability determinations to be made when recommending transactions to customers; (2) clarify the obligation of dealers to make reasonable efforts to obtain specific types of customer suitability information for all accounts that are not "institutional accounts" (*i.e.*, retail accounts); and (3) clarify the definition of "institutional account." The amendments will become effective upon approval by the Commission. Persons wishing to comment on the amendments should comment directly to the Commission.[1]

Background

In a letter dated May 8, 1992, the Director of the Division of Market Regulation of the Securities and Exchange Commission (SEC) asked the Board to review the requirements of rule G-19.[2] In September 1992, the Board published a Request for Comments on a number of customer protection issues, including the application of rule G-19 to customer transactions. After reviewing these matters, the Board decided that rule G-19 embodies the appropriate general standard for dealers in making a recommendation to a customer. Nevertheless, the Board recognized there was a perception among some observers that certain provisions of the rule could be viewed as permitting recommendations to go forward without proper regard to the nature of the security being recommended and the customer to whom it is recommended. Accordingly, at the May 1993 Board meeting, the Board approved a Request for Comments on draft amendments to clarify and strengthen the suitability requirements of rule G-19. The amendments were approved at the November 1993 Board meeting.

Rule G-19 generally requires that, before making any recommendation to a customer, a dealer must first determine that the proposed transaction is suitable for the customer. To strengthen rule G-19, the amendments eliminate two provisions from the rule which, in effect, are exceptions to this general requirement. The first such provision permits a dealer to make a recommendation when a customer refuses to provide sufficient information about himself for the dealer to determine that the recommendation is suitable for the customer. The provision states that a recommendation can go forward in this case as long as the dealer has no reasonable grounds to believe and does not believe that the recommendation is unsuitable (the "not unsuitable" provision). Although the Board did not conclude that this provision was the cause of customer protection problems (*i.e.*, there was no evidence that dealers relied on this provision to make unsuitable recommendations), the Board believed that the provision should be deleted to avoid any ambiguities regarding a dealer's obligation to make a suitability determination. Eliminating the provision also will prevent any future use of the provision as an excuse for unsuitable recommendations.

The second provision of rule G-19 that is removed by the amendments provides that a dealer, notwithstanding its determination that a transaction is not suitable for a customer, may, after so informing the customer of this, nevertheless respond to the customer's requests for investment advice and execute transactions at the direction of the customer. This "notwithstanding" provision allows dealers to recommend specific municipal securities to investors who want to invest in municipal securities even after being informed by the dealer that, based on their financial circumstances, investments in municipal securities would not be suitable. While there have been no reported problems associated with this provision, the Board,

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

[1] Comments sent to the Commission should refer to SEC File No. SR-MSRB-94-1.

[2] *MSRB Reports*, Vol. 12, No. 3 (Sept. 1992) at 6-7.

nevertheless, believed that this exemptive provision also should be deleted to strengthen the suitability rule.

The Board also decided to review and clarify the customer data inquiries that are necessary for non-institutional and institutional accounts. For non-institutional (*i.e.*, retail) accounts, the amendments clarify that dealers must make reasonable efforts to obtain the following information: the customer's financial status, tax status, investment objectives and such other information used or considered to be reasonable and necessary by the dealer in making recommendations to the customer.[3] For some institutional customers, however, these specific information requests may not be appropriate. For example, the "tax status" of a tax-exempt bond fund generally is not relevant to a suitability determination. Therefore, the amendment to rule G-19 does not provide a specific list of items that must be requested from all institutional accounts, but does state that dealers must obtain appropriate and sufficient data from each institutional customer to make a suitability determination for each transaction that is recommended (as also is required for non-institutional accounts).

Finally, the amendments revise the definition of "institutional account" contained in rule G-8. This definition is used in rule G-19, by cross-reference. This amendment would make the Board's definition of institutional account the same as the NASD's definition for purposes of suitability determinations.[4] Accounts that do not qualify as "institutional accounts" (*i.e.*, retail accounts) would be subject to the specific information inquiries described above.

Summary of Comments and Discussion

In August 1993, the Board published for comment the proposed rule change and received seven comment letters in response thereto.[5]

Comments on the General Approach of the Draft Amendments

In general, the commentators' reaction to the draft amendments was favorable. One commentator agreed with the Board's approach by stating that the draft amendments would address a "difficult problem" by deleting the "not unsuitable" and "notwithstanding" provisions from the current suitability rule. Another commentator noted that rule G-19 "as reformulated by the Board sets forth an appropriate affirmative standard." Two other commentators also expressed general support for the approach taken by the draft amendments.

Two commentators expressed reservations with removal of the "not unsuitable" and the "notwithstanding" provisions. One commentator opposed both changes because of its belief that the majority of its customers are not willing "to divulge their financial strength." Another commentator, while indicating that it does not make recommendations in municipal securities to customers, also believes that the "notwithstanding" provision should be retained because a customer may disagree with a dealer's opinion of unsuitability. That commentator indicated that dealers should be permitted to make recommendations to a customer who has already decided to purchase a municipal security and who asks for assistance in choosing an issue, even if the transaction would be unsuitable for the customer. While the "not unsuitable" and the "notwithstanding" provisions were initially adopted by the Board in the late 1970s for reasons similar to those cited by the commentators, there have been significant changes in the municipal securities market since that time. The number of retail investors has increased and the introduction of increasing numbers of complex, and in some cases, speculative, municipal securities has become a characteristic of today's market. In such an environment, it is critical that dealers have clear policies to ensure that salesmen do not recommend securities to customers without first establishing the suitability of the transaction. Therefore, the Board believes that the amendments deleting these provisions are necessary.

Comments on Specific Provisions of the Draft Amendments

Commentators offered several specific suggestions and sought guidance from the Board in a number of areas of the draft amendments.

Customer Account Data and Suitability Determinations

Several commentators noted that there are sometimes difficulties in obtaining the complete customer account data in all categories listed for retail customers in the draft amendments. The draft amendments state that a dealer must "make reasonable effort to obtain" the customer account data specified in the draft amendment to rule G-19(b). Two commentators were concerned as to what would happen if all such information could not be obtained. As indicated in the Request for Comments, this language does not necessarily preclude a dealer from making a recommendation if all items of information enumerated in the draft amendments cannot be obtained. Given the nature of the transaction (*e.g.*, the nature of the security and the known items of information about the customer), the dealer may have enough customer data to make a specific affirmative suitability determination for the recommendation, even if the customer refuses to provide some of the requested information. However, reasonable efforts must be made to obtain all customer information, listed in the draft amendments.

As noted above, the amount of customer information that is required to make a suitability determination depends in part upon the nature of the transaction recommended. With respect to some types of transactions—for example, those in more speculative securities—the amount of information needed to make a suitability determination will be greater than if a more conservative recommendation is being made. One commentator requested that the Board provide guidance on this subject

[3] The NASD requires its members to make reasonable efforts to obtain the same information from non-institutional customers. *See* NASD Manual, Rules of Fair Practice, Article III, Sec. 2(b).

[4] *See* NASD Manual, Rules of Fair Practice, Article III, Secs. 2 and 21.

[5] *MSRB Reports*, Vol. 13, No. 3 (June 1993) at 7-10. The comment letters are available for inspection at the Board's offices. As noted above, the Board in 1992, as part of its general review of customer protection, obtained various comments on rule G-19. Two commentators believed that removing the "not unsuitable" provision would not be a problem and would make the Board's rule consistent with normal practice in other securities markets. Three other commentators noted that some customers do not want to supply detailed financial information and thus were concerned over the removal of the provision.

by specifying "core" suitability information that must be obtained from a customer even when making a "conservative" recommendation. That commentator also requested that the Board provide specific guidance on what would be considered "more speculative" securities for which more detailed customer account data would be needed.

The draft amendment to rule G-19(b) clearly states that dealers must make reasonable efforts to obtain certain "core" customer suitability data for recommendations to non-institutional customers including: (i) the customer's financial status; (ii) the customer's tax status; (iii) the customer's investment objectives; and (iv) such other information used or considered to be reasonable and necessary by such broker, dealer or municipal securities dealer in making recommendations to the customer. If, after reasonable efforts, a dealer cannot obtain all such information regarding a customer, but nevertheless desires to proceed with a "conservative" transaction, the dealer must exercise its judgment, based on known information about the customer and the security, as to whether a suitability determination can be made. Furthermore, all information about the customer that is used in making this determination must be recorded in the customer account record under rule G-8(a)(xi)(F).

The Board also believes it to be inadvisable to attempt to provide detailed guidance on whether a particular security or proposed transaction is more "conservative" or more "speculative." The Board believes that dealers will have to make such decisions based on their knowledge of the security and the risks involved in the transaction. Attempts to state a universally applicable formula for such considerations could encourage the substitution of simplistic guidelines for the broader judgment that is sometimes required to determine whether a proposed municipal securities transaction includes a relatively low or high degree of risk.

Unsolicited Transactions

Several commentators requested that the Board provide guidance on how to identify and document "unsolicited" transactions, *i.e.*, transactions that are not recommended. Neither the current version of rule G-19 nor amendments precludes dealers from executing specific transactions at the request of customers, where no recommendation is made. Thus, the suitability requirements of the amendments would not apply to such "unsolicited" transactions.[6] It should be noted, however, that most municipal securities transactions are made in connection with recommendations. Because of its concern with customer protection and in recognition of the special characteristics of the municipal securities market,[7] the Board views the term "recommendation" (and the application of the Board's suitability requirement) broadly. For example, with respect to transactions occurring after investment seminars and in response to a dealer's advertisements, the Board has indicated that the suitability requirements of G-19 apply "in the same way they apply to all other recommendations made to customers."[8] Thus, although transactions may, in some instances, be "unsolicited" if a customer places an order for a specific security, transactions cannot be considered unsolicited if the order occurs after a dealer has mentioned a specific security to a customer (*e.g.*, in a listing of offerings, an advertisement or in any other communication by the dealer to the customer).

One commentator asked how "unsolicited" orders should be specified in a dealer's records, and whether such orders should always be handled by the dealer "as agent." Board rules do not require dealers to handle specific types of orders as either principal or agent. Rule G-8(a)(vi), however, specifies the recordkeeping requirements for the terms and conditions of an agency order, including the fact that it is an agency order. Similarly, rule G-15(a)(vii) requires the confirmation to state the agency role of a dealer in a transaction. Neither rule G-8 nor rule G-15 has provisions for documenting orders as "unsolicited."

As previously noted, relatively few transactions in municipal securities actually are "unsolicited." While documenting these relatively rare transactions as such on the confirmation and in the dealer's records may be prudent for the dealer's own protection, the Board is concerned that incorporating a requirement in the Board's rules might have the unintended effect of encouraging the classification of transactions as "unsolicited," even when they are not "unsolicited" under Board rules.

Institutional Accounts

The Board received several comments concerning the proposed definition for institutional account and the more generally stated suitability standard for institutional accounts. No commentator argued that it was inappropriate to distinguish between institutional and non-institutional investors when obtaining customer account data and making suitability determinations. One commentator believed the proposed standard for institutional investors was appropriate and noted that the information relevant to a suitability determination for a specific institutional account is necessarily a matter of judgment for the dealer. One commentator, however, suggested the establishment of specific minimum requirements for institutional accounts. Another commentator suggested that dealers should document the customer's investment objectives (including credit quality and maturity standards) and "other information" used or considered reasonable or necessary by the dealer. Another commentator suggested including corporate resolutions, trading authorization, and yearly audited financial statements as required information for institutional customers.

As indicated by several commentators, it is often necessary or advisable to obtain specific kinds of information from an institutional investor to make a suitability determination. Rule

[6] Of course, even if the transaction is "unsolicited," Board rules describe certain responsibilities which a dealer has to its customer. The fact that a transaction is "unsolicited" would not preclude an enforcement agency from bringing appropriate actions against a dealer for violation of these rules. For example, whether or not a transaction is "unsolicited," a dealer has a duty under rule G-17 to disclose all material facts to the customer.

[7] In the equity market, there is a strong self-initiated investor demand for particular securities so there are a large number of unsolicited transactions. By contrast, in the municipal securities marketplace, because of the thousands of available issues and rather generic nature of investor demand, a dealer makes a recommendation in most transactions.

[8] *See* "Notice Concerning the Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer's Advertisements," May 7, 1985, *MSRB Manual* (CCH) para. 3591.

G-8(a)(xi)(F) currently requires that the information used to make a suitability determination must be recorded. The amendment to rule G-8 also makes this requirement clear. In addition, rule G-8(a)(xi) also requires other customer account information including, among other things, the customer's name and address, tax identification or social security number and, with respect to discretionary accounts, the customer's written authorization. For various types of institutional accounts, it may be advisable for dealers to obtain certain additional data and documentation. Often this additional documentation may be necessary for the dealer's own protection (*e.g.*, trading authorizations).[9] Similarly, for certain institutional accounts, dealers may wish to obtain yearly audited financial statements where assurance is desired that the account is and remains an institutional account for the purpose of rule G-19.

Because of the wide variety in the types of institutional accounts and the documentation that might be necessary to establish suitability or otherwise considered by the dealer to be necessary and prudent, the Board believes that dealers ultimately will have to employ a certain degree of judgment in determining what information and documentation should be obtained and recorded for specific institutional customers beyond that now required by rule G-8(a)(xi).

One commentator noted that, in many instances, a suitability determination should be made on the basis of the investment objectives articulated by an institution for a specific transaction or a specific component of a large investment portfolio. In these cases, the overall investment objectives of the institution or portfolio may not be the deciding factor in determining suitability. This view is consistent with the current language of rule G-19 and the draft amendment to rule G-19, which requires that a dealer have reasonable grounds for recommending a transaction "based on the facts disclosed by such customer or otherwise known about such customer." If specific portfolio or transaction objectives are given, the draft amendments (and current Board rules) require that such information be used to make a suitability determination and be recorded pursuant to rule G-8(a)(xi)(F).

One commentator preferred the SEC's definition of "accredited investor" to the definition of "institutional account" in the draft amendments. The SEC's accredited investor definition includes a wide range of investors, such as any private business development company or individuals making in excess of $200,000 per year for three years. The term "accredited investor" is used as part of an exemptive provision from certain registration requirements under the Securities Act of 1933. Having a customer classified as an "accredited investor," however, does not excuse dealers from obtaining specific customer account data when making recommendations in equity transactions. Moreover, because "institutional account" —rather than "accredited investor"—is used by the NASD to define a dealer's customer account requirements, the use of a different test for municipal securities transactions would complicate the internal recordkeeping requirements of most securities firms.

Transactions with Investment Advisors

Finally, two commentators requested clarification of the suitability requirements that exist when a dealer executes a transaction for an investment advisor. In general, this question is answered by determining who the dealer's customer is—the investment advisor or the investment advisor's client. The Board believes that, in general, the investment advisor will be the dealer's customer. However, it is not possible to state this as an ironclad rule. The requirement for establishing suitability may depend on whether the beneficial owner is looking to the dealer or exclusively to the investment advisor for recommendations on investments.[10] The dealer, of course, should obtain the necessary customer account data from whomever is the customer. If the investment advisor is the customer, then the dealer would proceed as with other institutional accounts. However, if a dealer has a dealer-customer relationship with the beneficial owner and treats that entity as its own customer, then the dealer must obtain the information necessary to make a suitability determination. In this case, the investment advisor is treated as an interested party to the transaction.

January 6, 1994

Text of Proposed Amendments*

Rule G-19. Suitability of Recommendations and Transactions; Discretionary Accounts

(a) No change.

(b) ~~Knowledge of Customer. Each broker, dealer or municipal securities dealer at or before recommending the purchase, sale or exchange of a municipal security to a customer shall have knowledge or shall inquire about the customer's financial background, tax status, and investment objectives and any other similar information.~~

Non-institutional Accounts - Prior to recommending to a non-institutional account a municipal security transaction, a broker, dealer or municipal securities dealer shall make reasonable efforts to obtain information concerning:

(i) the customer's financial status;

(ii) the customer's tax status;

(iii) the customer's investment objectives; and

(iv) such other information used or considered to be reasonable and necessary by such broker, dealer or municipal securities dealer in making recommendations to the customer.

The term "institutional account" for the purposes of this section shall have the same meaning as in rule G-8(a)(xi).

[9] Currently, Board rule G-9(b)(E), on preservation of records, requires dealers to retain for three years all powers of attorney and other evidence of the granting of any authority to act on behalf of any account and copies of resolutions empowering an agent to act on behalf of a corporation.

[10] The mere fact that a confirmation is sent to a beneficial owner does not itself make the beneficial owner the dealer's customer. The Board has stated that, if an investment advisor places an order for a client and directs a dealer to confirm the transaction to the investment advisor's client, the recordkeeping requirement with respect to the advisor's client is limited. In that case, since the investment advisor itself was the dealer's customer, the dealer was required only to obtain the name and address of the investment advisor's client. However, in these situations, the account information applicable to institutional accounts must be obtained with respect to the investment advisor. Interpretative Notice on Recordkeeping (July 29, 1977) *MSRB Manual* (CCH) para. 3536.

* Underlining indicates new language; strikethrough denotes deletions.

(c) *Suitability of Recommendations.* ~~No broker, dealer or municipal securities dealer shall recommend the purchase, sale or exchange of a municipal security to a customer unless such broker, dealer or municipal securities dealer, after reasonable inquiry,~~

~~(i) has reasonable grounds based upon information available from the issuer of the security or otherwise for recommending a purchase, sale or other transaction in the security; and~~

~~(ii)(A) has reasonable grounds to believe and does believe that the recommendation is suitable for such customer in light of the customer's financial background, tax status, and investment objectives and any other similar information concerning the customer known by such broker, dealer or municipal securities dealer, or~~

~~(B) has no reasonable grounds to believe and does not believe that the recommendation is unsuitable for such customer if all of such information is not furnished or known.~~

~~Notwithstanding the foregoing, if a broker, dealer or municipal securities dealer determines that a transaction in municipal securities or in specific municipal securities would not be suitable for a customer and so informs such customer, the broker, dealer or municipal securities dealer may thereafter respond to the customer's requests for investment advice concerning municipal securities generally or such specific securities and may execute transactions at the direction of the customer.~~

In recommending to a customer any municipal security transaction, a broker, dealer, or municipal securities dealer shall have reasonable grounds:

(i) based upon information available from the issuer of the security or otherwise, and

(ii) based upon the facts disclosed by such customer or otherwise known about such customer

for believing that the recommendation is suitable.

(d) through (e) No change.

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

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

(i) through (x) No change

(xi) *Customer Account Information.* A record for each customer, other than an institutional account, setting forth the following information to the extent applicable to such customer:

(A) through (E) No change

(F) information about the customer ~~obtained~~ used pursuant to rule ~~G-19(b)~~ G-19(c)(ii) ~~such as the customer's financial background, tax status, and investment objectives or such other information used or considered to be reasonable~~ in making recommendations to the customer. For non-institutional accounts, all data obtained pursuant to rule G-19(b) shall be recorded.

(G) through (K) No change

For purposes of this subparagraph, the terms "general securities representative" and "general securities principal" shall mean such persons as so defined by the rules of a national securities exchange or registered securities association. For purposes of this subparagraph, the term "institutional account" shall mean ~~the account of an investment company as defined in section 3(a) of the Investment Company Act of 1940, a bank, an insurance company, or any other institutional type account.~~ 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. Anything in this subparagraph to the contrary notwithstanding, every municipal securities broker and municipal securities dealer shall maintain a record of the information required by items (A), (C), (F), (H), (I) and (K) of this subparagraph with respect to each customer which is an institutional account.

(xii) through (xv) No change

(b) through (f) No change

Notice of Approval

Route to:

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

Arbitration Changes: Rule G-35

Amendments Approved

The amendments conform the provisions of the Board's arbitration code to recent amendments to the Uniform Code approved by SICA.

On August 20, 1993, the Securities and Exchange Commission (Commission) approved amendments to rule G-35, the Board's Arbitration Code.[1] The Board requested that the Commission delay the effectiveness of the amendment to Section 36, concerning predispute arbitration agreements, until one year after Commission approval to provide dealers with sufficient time to amend their arbitration agreements. The remaining amendments became effective upon approval by the Commission.

Summary of Amendments

The amendments relate to various sections of the Arbitration Code, and are based on changes adopted by the Securities Industry Conference on Arbitration (SICA).[2]

Matters Subject to Arbitration (Section 1)

The amendments add new language to exclude class action claims from Board arbitration proceedings. The amendments also provide that a claimant may pursue a claim in arbitration even if that claim is the subject of a class action, as long as the claimant has complied with any court-imposed conditions for properly withdrawing from the class. In addition, the amendments prohibit dealers from attempting to compel a customer to arbitrate a claim included in a class action, or from attempting to enforce an arbitration agreement against any customer that has initiated a class action claim in court and who has not opted out of the class, until a court denies class certification, the class is decertified, or the court excludes the customer from the class.

Persons Subject to the Board's Arbitration Code (Section 2)

In general, Board rules state that they apply to "brokers, dealers, and municipal securities dealers." However, Sections 1 and 2 of the arbitration code speak in terms of "municipal securities broker and municipal securities dealer." Thus, the amendments conform these references to the statutory reference to Section 15B(b)(2) of the Act, thereby promoting consistency among Board rules.

Joinder and Consolidation — Multiple Parties (Section 5)

The amendments provide that (i) all claimants may join in one action if their claims arise out of the same transaction; (ii) all respondents may be joined in one action if the claims asserted against them arise out of the same transaction; and (iii) judgments may be apportioned according to the claimants' rights to relief and the respondents' liabilities. In addition, the amendments clarify that parties are permitted to file claims with multiple claimants, that the Director of Arbitration is permitted to consolidate claims that have been filed separately, and that all further determinations made by an arbitration panel concerning such matters shall be deemed final.

Designation of Time and Place of Hearings (Section 16)

This amendment is intended to ensure that a dealer cannot unfairly control the selection of a hearing location and in so doing cause a customer to incur unreasonable costs in pursuing an arbitration claim.

Failure to Appear (Section 19)

The amendments to this section clarify that arbitrators are authorized to proceed with and dispose of a case if a party fails to appear at a hearing or at any continuation of a hearing session.

Discovery (Section 22)

The amendments to this section clarify when discovery requests may be served.

Questions about the amendments may be directed to Jill C. Finder, Assistant General Counsel, or Denise P. Person, Arbitration Administrator.

[1] SEC Release No. 34-32780.

[2] Since 1977, SICA has worked to develop a Uniform Code of Arbitration in an effort to promote consistency in the securities industry arbitration process. Board rule G-35 closely follows the Uniform Code.

Party Service of Amended Pleadings (Section 29)

The amendments to this section require that parties serve copies of amended pleadings on all other parties and provide the Director of Arbitration with sufficient additional copies for each arbitrator.

Awards (Section 31)

The amendments provide that interest shall accrue on awards that are not paid within 20 calendar days of receipt unless a motion to vacate has been filed in court. The amendments also provide that interest on awards shall be assessed at either the prevailing "legal" rate in the state where the award was rendered or at a rate specified by the arbitrators.

In addition, the amendments require that awards contain (among other information) the names of counsel, if any. This amendment is intended to enhance the general flow of information about arbitration proceedings.

Agreement to Arbitrate (formerly entitled "Miscellaneous") (Section 32)

The amendments are intended to ensure that a party who does not sign a submission agreement, but is subject to other agreements to arbitrate, also is bound by the Board's arbitration code.

Use of Simplified Arbitration for Small Claims (Section 34)

The amendments to paragraph (a), concerning use of simplified arbitration procedures, eliminate the requirement that a customer demand use of such procedures before they can be implemented. The amendments also eliminate the requirement that parties first consent in writing to use of these procedures.

The amendments to paragraph (d), concerning referring claims, counterclaims, and third-party claims to a panel of arbitrators, are intended to correct earlier changes to this section, in conformity with Section 12(a) of the Board's arbitration code.

The amendments to paragraph (h), concerning submission of further documentary evidence in simplified arbitration procedures, add new language which (1) codifies the applicability of Board discovery procedures to simplified arbitrations when a public customer demands a hearing; and (2) establishes a procedure to resolve discovery disputes when no hearing is demanded or consented to. This latter amendment includes setting shorter time frames for discovery under such circumstances, in keeping with the Board's (and SICA's) policy of expediting small claims.

Simplified Arbitration — Intra-Industry (Section 35)

The amendments to paragraph (a) clarify that only those inter-dealer small claims that are subject to the Board's arbitration code shall be resolved pursuant to the simplified procedures set forth in this section.

The amendments to paragraph (c), concerning referring claims, counterclaims, and third-party claims to a panel of arbitrators, are intended to correct earlier changes to this section, in conformity with Section 12(b) of the Board's arbitration code.

Predispute Arbitration Agreements (Section 36)

The amendments add new language requiring that all new predispute arbitration agreements signed by customers must include a prescribed statement excluding class actions from the arbitration contract and clarifying investors' ability to pursue class actions in court.[3] This language is intended to prohibit dealers from bringing class actions to arbitration and from attempting to enforce an agreement to arbitrate against a member of a class action. This amendment applies only to new agreements signed by an existing or new customer. As noted above, the Board requested that the Commission delay the effectiveness of this particular amendment to Section 36 until one year after Commission approval, in order to provide dealers with sufficient time to amend their arbitration agreements. Thus, all new predispute arbitration agreements signed after August 20, 1994 must include the prescribed language.

September 30, 1993

Text of Amendments*

Rule G-35. Arbitration

Every ~~municipal securities~~ broker, dealer and municipal securities dealer shall be subject to the Arbitration Code set forth herein.

Arbitration Code

Section 1. *Matters Subject to Arbitration*

(a) This Arbitration Code shall apply to every claim, dispute or controversy arising out of or in connection with the municipal securities activities of a ~~municipal securities~~ broker, dealer or municipal securities dealer acting in its capacity as such which is submitted to arbitration pursuant to section 2 of this Arbitration Code, except in the event that all of the parties to the claim, dispute or controversy agree to arbitrate it in another forum.

(b) *Class Action Claims*

(1) A claim submitted as a class action shall not be eligible for arbitration under this Code.

(2) A claim filed by a member or members of a putative or certified class action shall not be eligible for arbitration under this Code if the claim is encompassed by a putative or certified class action filed in federal or state court, or is ordered by a court to a non self-regulatory organization forum for classwide arbitration. Such claims shall be eligible for arbitration pursuant to Section 2(b) of this Code, or pursuant to the parties' contractual agreement, if any, if a claimant demonstrates that it has elected not to participate in the putative or certified class action or, if applicable, has complied with any conditions for withdrawing from the class prescribed by the court.

Disputes concerning whether a particular claim is encompassed by a putative or certified class action shall be

[3] See the amendments to Section 1, above, concerning class actions.

* Underlining indicates additions; strikethrough indicates deletions.

referred by the Director of Arbitration to a panel of arbitrator(s) in accordance with section 12 or section 34 of this Code, as applicable. Either party may elect instead to petition the court with jurisdiction over the putative or certified class action to resolve such disputes. Any such petition to the court must be filed within 10 business days from receipt of notice that the Director of Arbitration is referring the dispute to a panel of arbitrator(s).

(3) No broker, dealer or municipal securities dealer and/or associated person of a broker, dealer or municipal securities dealer shall seek to enforce any agreement to arbitrate against a customer that has initiated in court a putative class action or is a member of a putative or certified class with respect to any claims encompassed by the class action unless and until:

(i) the class certification is denied; or

(ii) the class is decertified; or

(iii) the customer is excluded from the class by the court; or

(iv) the customer elects not to participate in the putative or certified class action or, if applicable, has complied with any conditions for withdrawing from the class prescribed by the court.

(4) No broker, dealer or municipal securities dealer and/or associated person of a broker, dealer or municipal securities dealer shall be deemed to have waived any of its rights under this Code or under any agreement to arbitrate to which it is a party except to the extent stated in this paragraph (b).

Section 2. *Persons Subject to the Provisions of the Arbitration Code*

Any claim, dispute or controversy subject to arbitration in accordance with section 1 of this Arbitration Code shall be submitted to arbitration pursuant to this Arbitration Code at the instance of:

(a) a ~~municipal securities~~ broker, dealer or municipal securities dealer against another ~~municipal securities~~ broker, dealer or municipal securities dealer;

(b) a person other than a ~~municipal securities~~ broker, dealer or municipal securities dealer against a ~~municipal securities~~ broker, dealer or municipal securities dealer; or

(c) a ~~municipal securities~~ broker, dealer or municipal securities dealer against a person other than a ~~municipal securities~~ broker, dealer or municipal securities dealer, provided that the submission to arbitration is pursuant to a duly executed and enforceable agreement to arbitrate and is in accordance with section 29 of the Act.

Sections 3 through 4. no change.

Section 5. *Initiation of Proceedings*

Except as otherwise provided herein, an arbitration proceeding under this Arbitration Code shall be instituted as follows:

(a) through (c) no change.

(d) *Joinder and Consolidation—Multiple Parties*

~~(1) With respect to any dispute, claim or controversy submitted to arbitration, any party or person eligible to submit a claim under this Arbitration Code shall have the right to proceed in the same arbitration against any other party or person upon any claim directly related to such dispute.~~

(1) Permissive Joinder. All persons may join in one action as claimants if they assert any right to relief jointly, severally, or arising out of the same transaction, occurrence or series of transactions or occurrences and if any questions of law or fact common to all these claimants will arise in the action. All persons may be joined in one action as respondents if there is asserted against them, jointly or severally, any right to relief arising out of the same transaction, occurrence or series of transactions or occurrences and if any questions of law or fact common to all respondents will arise in the action. A claimant or respondent need not assert rights to or defend against all the relief demanded. Judgment may be given for one or more of the claimants according to their respective rights to relief, and against one or more respondents according to their respective liabilities.

(2) ~~For purposes of this subsection, the Director of Arbitration shall be authorized to determine preliminarily whether a claim is directly related to the matter in dispute and to join any other party to the dispute and to consolidate the matter for hearing and award purposes.~~ In arbitrations where there are multiple claimants, respondents and/or third-party respondents, the Director of Arbitration shall be authorized to determine preliminarily whether such parties should proceed in the same or separate arbitrations. Such determination will be considered subsequent to the filing of all responsive pleadings.

(3) The Director of Arbitration shall be authorized to determine preliminarily whether claims filed separately are related and shall be authorized to consolidate such claims for hearing and award purposes.

(4) ~~(3) All final~~ Further determinations ~~in~~ with respect ~~of joining,~~ to joinder, consolidation and multiple parties under this subsection shall be made by the arbitration panel and shall be deemed final.

Sections 6 through 15. no change.

Section 16. *Designation of Time and Place of Hearings*

~~Unless the law directs otherwise, t~~ The time and place of the initial hearing shall be determined by the Director of Arbitration and for each ensuing hearing thereafter by the arbitration panel. Notice of the initial hearing shall be delivered at least eight business days prior to the date fixed for hearing by personal service or registered or certified mail to each of the parties and for each hearing thereafter as the arbitration panel shall determine, unless the parties shall by their mutual consent waive the notice provisions provided under this section. Attendance at a hearing constitutes a waiver of notice thereof.

Sections 17 through 18. no change.

Section 19. *Failure to Appear*

If any of the parties, after due notice is given as provided herein, fails to be present or represented at a hearing or at any ~~adjourned~~ continuation of a hearing session, the arbitrators may, in their own discretion, proceed with the arbitration of the claim, dispute or controversy. In such cases, all awards shall be rendered as if each party had entered an appearance in the matter submitted.

Sections 20 through 21. no change.
Section 22. *Discovery*
(a) no change.
(b) *Document Production and Information Exchange*
(1) Any party may serve a written request for information or documents ("information request") upon another party twenty (20) business days or more after service of the statement of claim by the Director of Arbitration or upon ~~service~~ filing of the answer ~~by the Director of Arbitration~~, whichever is earlier. The requesting party shall serve the written information request on all parties and file a copy with the Director of Arbitration. The parties shall endeavor to resolve disputes regarding an information request prior to serving any objection to the request. Such efforts shall be set forth in the objection.
(2) through (4) no change.
(c) through (e) no change.

Sections 23 through 28. no change.
Section 29. *Amendment of Pleadings*
(a) After the filing of any pleadings, if a party desires to file a new or different pleading, such change must be made in writing and filed with the Director of Arbitration with sufficient additional copies for each arbitrator. The party filing a new or different pleading shall serve on all other parties a copy of the new or different pleading in accordance with the provisions set forth in section 5(c)(1). ~~The Director of Arbitration shall endeavor to serve promptly by mail or otherwise upon all other parties a copy of said change.~~ The other parties may, within 10 business days from the receipt of service, file a response with all other parties and the Director of Arbitration in accordance with section 5(c)(1).
(b) No change.

Section 30. no change.
Section 31. *Awards*
(a) through (d) no change.
(e) Upon receipt by a broker, dealer or municipal securities dealer ("dealer") of a monetary award rendered against it, the dealer, within 20 calendar days, shall:
(1) deliver the amount of the award to the prevailing party (subject to any action required of the prevailing party by the award as a precedent to payment), or
(2)(i) if the dealer is considering a motion to vacate ~~an appeal of~~ the award:
(A) deposit the amount of the award with a bank (the "escrow agent") in an escrow account pursuant to an escrow agreement which includes certain provisions described below, or
(B) provide to the prevailing party an irrevocable standby letter of credit ("letter of credit") for the amount of the award setting forth the terms and conditions for payment described below.
(ii) Immediately upon deposit by the dealer of the amount of the award in an escrow account, the dealer must notify the prevailing party in writing of the deposit of the arbitration award, the name and address of the escrow agent, and the final date a motion to vacate ~~an appeal~~ may be filed according to relevant state or federal law ("motion ~~appeal~~ date"). The escrow agreement must provide that, if a motion to vacate ~~an appeal~~ is not filed by the motion ~~appeal~~ date, or filed but later withdrawn by the dealer prior to the entry of a final court order, the escrow agent will deliver the amount of the award to the prevailing party within two business days after the motion ~~appeal~~ date or the withdrawal date. If a motion to vacate ~~an appeal~~ is filed, the amount of the award shall be held by the escrow agent until the entry of a final court order on the motion ~~appeal~~. The escrow agreement must provide that, within 10 business days of the entry of the final court order, the escrow agent will deliver the amount of the award in accordance with the court's order.
(iii) If a letter of credit is provided, it must provide that the amount of the award will be disbursed to the prevailing party by the letter of credit issuer upon certification by the prevailing party that the dealer has not paid the amount of the award and:
(A) a motion to vacate ~~an appeal~~ has not been filed by the motion ~~appeal~~ date, or
(B) a motion to vacate ~~an appeal~~ has been filed but later withdrawn by the dealer prior to the entry of a final court order, or
(C) a final court order on the motion to vacate ~~appeal~~ has been entered in favor of the prevailing party.
(iv) no change.
(f) A monetary award shall bear interest from the date of the award: (i) if not paid within 20 calendar days of receipt; or (ii) if the award is the subject of a motion to vacate which is denied, or which has been filed but later withdrawn by a party prior to the entry of a final court order; or (iii) as specified by the arbitrator(s) in the award. Interest shall be assessed at the legal rate, if any, then prevailing in the state where the award was rendered, or at a rate set by the arbitrator(s).
(g) ~~(f)~~ The award shall contain: (1) the names of the parties and the names of counsel, if any; (2) a summary by the arbitrators of the issues in controversy, the damages and/or other relief requested, the damages and/or other relief awarded, and a statement of any other issues resolved; ~~and~~ (3) the names of the arbitrators; (4) the dates the claim was filed and the award was rendered; (5) the number and dates of hearing sessions, and the location of the hearing(s), and (6) the signatures of those arbitrators concurring in the award.
(h) ~~(g)~~ no change.

Section 32. ~~Miscellaneous~~ *Agreement to Arbitrate*
This Arbitration Code shall be deemed a part of and incorporated by reference in every agreement to arbitrate under the rules of the Municipal Securities Rulemaking Board, including a duly executed Submission Agreement ~~which shall be binding on all parties~~.

Section 33. no change.
Section 34. *Simplified Arbitration for Small Claims Relating to Transactions with Customers*
(a) Any claim, dispute or controversy, arising between a customer and a broker, dealer or municipal securities dealer, subject to arbitration under this Arbitration Code, which involves a dollar amount not exceeding $10,000 (exclusive of attendant costs and interest), shall ~~upon demand of the customer or by written consent of the parties~~ be arbitrated as hereinafter provided.
(b) and (c) no change.

(d) The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the respondent(s) one copy of the Submission Agreement and one copy of the statement of claim. Within 20 calendar days from receipt of the statement of claim, the respondent(s) shall serve each party with an executed Submission Agreement and a copy of respondent's answer. Respondent's executed Submission Agreement and answer shall also be filed with the Director of Arbitration with sufficient additional copies for the arbitrator(s) along with any deposit required under rule A-16. The answer shall designate all available defenses to the claim and may set forth any related counterclaim and/or related third-party claim the respondent(s) may have against the claimant or any other person. If the respondent(s) has interposed a third-party claim, the respondent(s) shall serve the third-party respondent with an executed Submission Agreement, a copy of respondent's answer containing the third-party claim, and a copy of the original claim filed by the claimant. The third-party respondent shall respond in the manner herein provided for response to the claim. If the respondent(s) files a related counterclaim exceeding $10,000, the arbitrator may refer the claim, counterclaim and/or third-party claim, if any, to a panel of ~~three (3) or five (5)~~ arbitrators, the size and composition of which shall be determined in accordance with section 12(a) of this Code, or the arbitrator may dismiss the counterclaim and/or third-party claim without prejudice to the counterclaimant(s) and/or third-party claimant(s) pursuing the counterclaim and/or third-party claim in a separate proceeding. The costs to the claimant under either proceeding shall in no event exceed the total amount specified in rule A-16.

(e) through (g) no change.

(h) The arbitrator shall be authorized to require the submission of further documentary evidence as he in his sole discretion deems advisable:

(1) If a hearing is demanded or co[illegible]nted to in accordance with section 34(f), the Discovery provisions under section 22 of this Code shall apply.

(2) If no hearing is demanded or consented to, any written request for information or documents ("information request") shall be filed with the Director of Arbitration within 10 business days of notification of the identity of the arbitrator selected to decide the claim, dispute or controversy. The requesting party shall serve simultaneously its information request on all parties. Any response or objection to the information request shall be served on all parties and filed with the Director of Arbitration within 5 business days of receipt of the information request. The arbitrator shall resolve all disputes under this subsection on the papers submitted.

(i) through (l) no change.

Section 35. *Simplified Arbitration for Small Claims Relating to Intra-Industry Transactions*

(a) Any claim, dispute or controversy between or among brokers, dealers and municipal securities dealers, subject to arbitration under this Arbitration Code, which involves a dollar amount not exceeding $10,000 (exclusive of attendant costs and interest), shall be arbitrated as hereinafter provided.

(b) No change.

(c) The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the respondent(s) one copy of the Submission Agreement and one copy of the statement of claim. Within 20 calendar days from receipt of the statement of claim, the respondent(s) shall serve each party with an executed Submission Agreement and a copy of respondent's answer. Respondent's executed Submission Agreement and answer shall also be filed with the Director of Arbitration with sufficient additional copies for the arbitrator(s) along with any deposit required under rule A-16. The answer shall designate all available defenses to the claim, state whether or not a hearing is requested, and may set forth any related counterclaim and/or related third-party claim the respondent(s) may have against the claimant or any other person. If the respondent(s) has interposed a third-party claim, the respondent(s) shall serve the third-party respondent with an executed Submission Agreement, a copy of respondent's answer containing the third-party claim, and a copy of the original claim filed by the claimant. The third-party respondent shall respond in the manner herein provided for response to the claim. If the respondent(s) files a related counterclaim exceeding $10,000, the arbitrator may refer the claim, counterclaim and/or third-party claim, if any, to a panel of ~~three (3) or five (5)~~ arbitrators, the size and composition of which shall be determined in accordance with section 12(b) of this Code, or the arbitrator may dismiss the counterclaim and/or third-party claim without prejudice to the counterclaimant(s) and/or third-party claimant(s) pursuing the counterclaim and/or third-party claim in a separate proceeding. The costs to the claimant under either proceeding shall in no event exceed the total amount specified in rule A-16.

(d) through (i) no change.

Section 36. *Predispute Arbitration Agreements with Customers*

(1) through (4) No change.

(5) All agreements shall include a statement that:

"No person shall bring a putative or certified class action to arbitration, nor seek to enforce any predispute arbitration agreement against any person who has initiated in court a putative class action; who is a member of a putative class who has not opted out of the class with respect to any claims encompassed by the putative class action until:

(a) the class certification is denied; or

(b) the class is decertified; or

(c) the customer is excluded from the class by the court.

Such forbearance to enforce an agreement to arbitrate shall not constitute a waiver of any rights under this agreement except to the extent stated herein."

(6) ~~(5)~~ The requirements of paragraphs (1) through (4), above, ~~this section~~ shall apply only to new agreements signed by an existing or new customer of a dealer after December 1, 1989. The requirements of paragraph (5), above, shall apply only to new agreements signed by an existing or new customer of a dealer after August 20, 1994.

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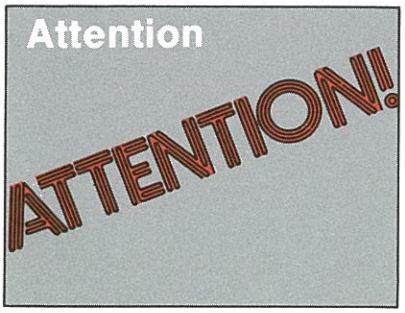
MSRB REPORTS

January 1994



Route to:

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

Letter of Interpretation

Rule G-32. Disclosures in connection with new issues

This is in response to your November 30, 1993 letter requesting interpretive guidance regarding Board rule G-32(a)(ii)(C). That provision requires dealers in connection with a negotiated sale of new issue municipal securities to disclose "the initial offering price for each maturity in the issue that is offered or to be offered in whole or in part by the underwriters." You inquired as to whether the term "initial offering price" as used in this provision could be stated in terms of yield. The Board has reviewed your request and authorized this response.

Rule G-32 requires dealers selling new issue municipal securities to provide certain written information to customers. In connection with new negotiated issues, paragraph (a)(ii) of the rule requires that this written information include the underwriting spread, the amount of any fee received by a dealer as agent for the issuer in the distribution of the securities for each maturity in the issue that is offered or to be offered in whole or in part by the underwriters, and the initial offering price of each maturity.[1]

With respect to the "initial offering price," the Board has concluded that this price may be expressed either in terms of dollar price or yield. Since customer confirmations generally must show both dollar price and yield, the Board believes that either form of "initial offering price" would provide customers with the requisite comparative data about the relationship between the initial offering price and the price of the securities being purchased.

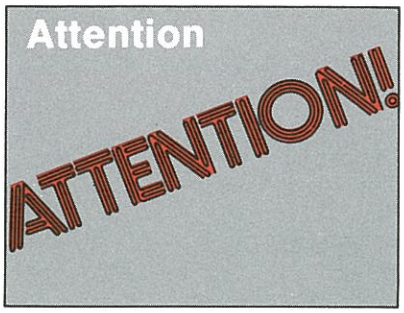
MSRB Interpretation of December 22, 1993.

[1] If this information is stated in the official statement, compliance can be achieved by delivering the official statement to the customer, prior to settlement, as is required, in any case, by rule G-32(a)(i). However, if the information is not in the official statement, this information must be delivered no later than the settlement of the transaction.

Volume 14, Number 1

MSRB REPORTS

January 1994



Route to:

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

Recommendations Requested for Board Nominations

The 1994 Nominating Committee requests recommendations of persons to be considered for five Board positions opening on October 1, 1994.

Membership Requirements

The Board, established by Congress in 1975 to act as the primary rulemaking body for the municipal securities industry, consists of 15 members—five representatives of bank dealers, five representatives of securities firms and five public members. One public member must represent issuers and one investors. Public members may not be associated with a securities firm or bank dealer other than by reason of being under common control with, or directly controlling, any broker or dealer which is not a municipal securities broker or municipal securities dealer.

When making recommendations, keep these Board membership requirements in mind:

- One public representative, two securities firm representatives and two bank dealer representatives must be elected this year to ensure equal representation in each category;
- Municipal securities brokers and municipal securities dealers of diverse size and type must be represented; and
- Wide geographic representation must be maintained.

Procedure for Recommending Candidates

1. Complete the form printed on page 35 or a photocopy of that form. (Additional forms may be obtained from the Board's offices). The following information must be included on the form:
   - The name, business affiliation, business address and telephone number, home address and telephone number and category (bank dealer, securities firm or public representative) of the individual recommended. (Item 1)
   - The educational and professional background of the individual recommended. (Item 2)
   - The proposer's name, business address, telephone number and professional relationship (if any) to the individual recommended. (Item 3)
   - The affiliation (if any) of the individual with any broker, dealer or municipal securities dealer. (Item 4)
2. Determine in advance that the individual recommended is willing to serve on the Board.
3. Submit recommendations no later than March 18, 1994 to:

Ruth E. Smith
Chair, Nominating Committee
Municipal Securities Rulemaking Board
1818 N Street, NW Suite 800
Washington, DC 20036-2491

Terms of Present Board Members

Terms Expire September 30, 1994

Edwin B. Horner, III, Senior Vice President and Manager
Scott & Stringfellow, Inc.
Lynchburg, Virginia

Robert B. Inzer, City Treasurer - Clerk
City of Tallahassee
Tallahassee, Florida

Gregory C. Menne, Director - Fixed Income Management
A.G. Edwards & Sons, Inc.
St. Louis, Missouri

Ruth E. Smith, Senior Vice President
Capital Markets Department
Texas Commerce Bank National Association
Houston, Texas

M. Rex Teaney, President
Franklin Street Trust Company
Chapel Hill, North Carolina

Terms Expire September 30, 1995

David C. Clapp, Partner
Goldman, Sachs & Co.
New York, New York

Robert H. Drysdale, President and Chief Executive Officer
PNC Securities Corp.
Pittsburgh, Pennsylvania

Frederick W. Gaertner, Vice President
The Chubb Corporation
Warren, New Jersey

Walter K. Knorr, City Comptroller
City of Chicago
Chicago, Illinois

Phillip E. Peters, Chief Investment Officer
Boatmen's Bancshares, Inc.
St. Louis, Missouri

Terms Expire September 30, 1996

Alan Appelbaum, Partner
Cleary, Gottlieb, Steen & Hamilton
New York, New York

Alice W. Handy, Treasurer
University of Virginia
Charlottesville, Virginia

Edward J. Reinoso, President
Reinoso & Company, Incorporated
New York, New York

Andrew F. Rowley, Managing Director
Morgan Stanley & Co., Inc.
New York, New York

Anthony J. Taddey, Senior Vice President and Director
Municipal Securities Group
Bank of America
Los Angeles, California

Recommendation Form

1. Individual Recommended: _____

Business Address: _____ Home Address: _____

_____ _____

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Educational: _____

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Associations: _____

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3. Proposer: _____

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4. Associated Person under Securities Exchange Act of 1934: _____

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